



ISSUE OF ENTERPRISE'S VALUE AND ITS INCREASE BEFORE IPO. IMPROVEMENT MEASURES IN THE REPUBLIC OF UZBEKISTAN

Akbarali Babanazarovich Uralov

PhD, Associate Professor, Department Of Economics Of Oil And Gas, Branch Of The Russian State University Of Oil And Gas, (National Research University) Named After I.M. Gubkin In Tashkent, Uzbekistan

ABSTRACT

This paper analyzes the issue of company's value before business moves to the IPO stage within its lifecycle. Given the contemporary realities, the article reveals its increasing significance in the Republic of Uzbekistan and implemented measures towards this matter. Moreover, the paper exhibits main company valuation approaches and establishes the key indicators that mostly impact on business value within pre-IPO stage. Based on the literature available, it is notable that there exists a big concern of overestimation of enterprise's value which top management experiences prior sliding a company to IPO. Suggestions are given and include some optimization tools of value management of business to avoid such consequences and more likely correspond to the market expectations and the fair value.

KEYWORDS:- Fair Value, Initial Public Offering, Economic Reforms, Stock Market, Decrees, Investors, Overvaluation, Undervaluation, Investments, Analysis, Financial Modeling, Factors, Approaches, Capital, Management, Optimization, Measures.

INTRODUCTION

Initial public offering (IPO) is the regular stage within development of almost any large company. Initial public offerings attract additional funds, and the company receives an incentive for further growth. IPO not only enables wide market opportunities for the company, but also allows it to gain market capitalization. Hence, in order to succeed in

IPO, company faces the issue of increase of enterprise's value before moving to IPO. Given that the company's profit illustrates its operation efficiency within the current period, then enterprise value also gives a picture of expectations associated with company, estimation of company's ability to generate profit in the future. As a result, ensuring the growth of enterprise value is one of company's key goals before going public.

As regards Republic of Uzbekistan, this issue becomes urgently important and actual since modern Uzbekistan experiences a significant economic and political reforms within past five years. To be more precise, a number of governmental regulations and decrees are adopted and discussed. According to Resolution #268 (2017) of Cabinet of Ministers, different measures were enacted for the first time and accepted to further simplify procedures and accelerate the sale of state property for use for business purposes, as well as in order to introduce forms of sale of state property objects widely used in international practice and attracting broad layers of the population to the stock market. These measures are aimed to improve the efficiency of firms' operation and to actively attract investments in order to increase enterprises' capacities. Moreover, pursuant to the Presidential Decree #4124 (2019) and Cabinet of Ministers Resolution #358 (2019), a significant concept of organizing IPO at the stock market and necessary requirements towards improvement of investment climate in the country has been established and

stipulated.

The question of the paper is the issue of enterprise's value and its increase before IPO. The purpose of this paper is to elaborate this issue and towards this matter, the following objectives have been set:

- To study the principles of assessing the value of an enterprise and its role in management of company's value;
- To explore the different approaches used in examining enterprise's value;
- To identify the main factors that are mainly referred to while firm's value management;
- To suggest the measures to optimize the enterprise's value management.

This work consists of five sections. Section I reveals the introduction and actuality of the current issue. Section II explains the context and conditions of enterprise's fair valuation, gives the particular cases of overvalued and undervalued companies. Section III discusses techniques that company is valued through and describes main factors that have an



Accepted 10th December, 2021 & Published 20th December, 2021

impact on its value. Section IV suggests a couple of improvement measures of valuation management of business. Section V summarizes the elaborated discussions and concludes the paper.

MAIN PART

Circumstances of fair valuation of company

Given the instability of the modern economy, most companies at different stages of their life cycle seek to improve their positions by public offering of shares on the stock exchange that is an IPO (Initial Public Offering). In most cases, an IPO is made after the mezzanine (intermediate) stage, while there is a pattern: the younger the company is, the more added capital it will be able to attract, while the risk of a company's value decrease and, as a result, exit from the market is highly likely possible (SEC, 2021).

On the one hand, mechanism of IPO allows companies to achieve a new level of business transformation with large-scale capital raising in order to execute large projects or takeover of another company, as well as

ensure the company's liquidity for shareholders and optimize the capital structure. On the other hand, moving to IPO may not be beneficial for the company, since it carries the risk of the share price falling below the trading start level, which negatively affects the company's value. Hence, taking into account abovementioned, companies may be overvalued or undervalued which implies the actuality of the issue of companies' fair valuation at the pre-IPO stage within the economic turbulence. Issues of under- and overvaluation are treated as crucial ones within business value management. This fact can be well demonstrated and proven by the cases below.

Examples of overvalued companies.

The Chinese company Wanda Sports Group that has FIFA affiliations and previously held the Ironman trademark, planned to sell over 33 million shares for \$12-\$15 each within IPO. Wanda plunged 36% on its Nasdaq opening in July 2019, though rather than earning \$500 million as expected, and stocks

wound up being valued little over \$5 apiece (Bloomberg, 2019). Within the following months, shares continued to fall. By February 2020, it had decreased 62 percent, which compelled the company to market its Ironman business for \$730 million in cash (GlobeNewswire, 2020).

SmileDirectClub, the American Tennessee-based supplier of invisible dental aligners, decided to go public in September 2019. An overprovisioning to the firm's first offering

forced the company to value its stocks at \$23. This offer put the company's worth at \$9 billion, that was considerably above \$3.2 billion in its last fundraising cycle 11 months ago. Nonetheless, during the first trade day, shares plunged 28 percent and ended up at below \$17 (Debter, 2019). Besides, due to the COVID-19 crisis that wreaked havoc on retails, the shares price had declined 44 percent since the IPO by June 2020.



Figure 1. SmileDirectClub's stock stagnated in comparison with S&P 500 Levels.

Source: The Motley Fool (2020).

Xiaomi, the Chinese large smartphone manufacturer, stepped into the IPO in July 2018. Initially the company intended to sell

2.18 billion shares and set price at around HK\$17 each. Before moving to IPO, investors valued the company for \$54 billion which became a significant achievement according



Accepted 10th December, 2021 & Published 20th December, 2021

to Bloomberg (2018). As per primary expectations, capitalization should have reached \$100 billion. Nevertheless, though the shares were being sold at HK\$19 apiece at the first day of trades on Honk Kong stock exchange, they shrank 56% to the value of \$8.4 each by November 2019 (Bloomberg, 2020). At the beginning of trades, Chinese manufacturer could just earn \$4.7 billion when compared to the intended \$10 billion.

Examples of undervalued companies

IPO of giant media platforms such as Facebook was treated with both great hopes and criticism. Social media network was seeking a worth of more than \$100 billion that was 108 times their yearly revenue at that moment. Google, for instance, was being sold at less than 19 times their profits. Lots of traders were cautious and claimed that for Facebook's value to be maintained, there should observe the massive financial improvement and generate new income sources. In May 2012, the social network company came out publicly. The stocks were first launched at \$38 apiece but quickly fell in

price within next weeks, having erased \$50 billion in value by August. (Walton, 2020) The company, whereas, has skyrocketed since then. The social networks titan is estimated around \$700 billion and shares are marketed at over \$250 each as of January 2021. Despite facing various domestic and external regulatory obstacles, particularly antimonopoly proceedings, Facebook keeps reporting good financial performance.

When its IPO was placed in 2015, Square, digital payment processing business, was priced at \$2.9 billion, away from a VC-backed estimate of \$5.3 billion. There existed scepticism of investors that the company would be able to compete in the industry and generate profits. Square has eventually rebounded and rapidly risen, attributed to the increased use of digital payments and e-commerce. This trend has been driven by the COVID-19 crisis. Moreover, the company has become a player in the cryptocurrency market, that offers its customers to access to bitcoin via the mobile wallet Cash App.

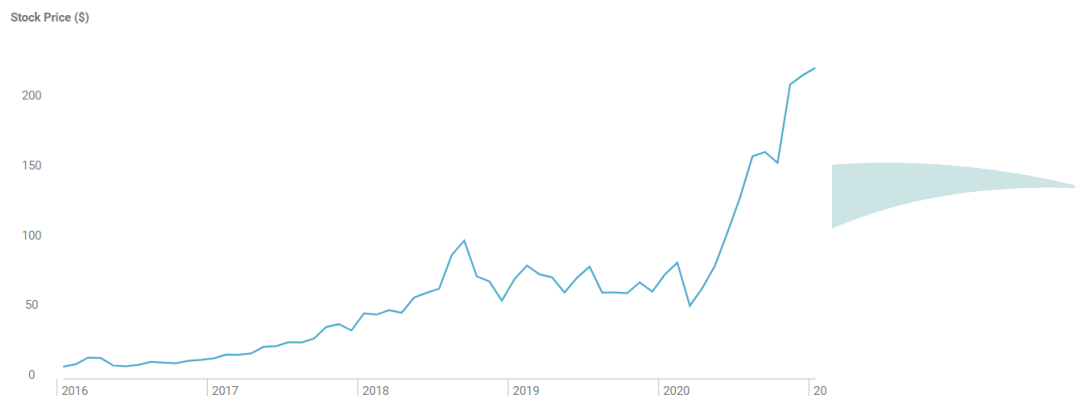


Figure 2. Square stock price. Source: CB Insights Research (2021)

Square announced net profit at above \$3 billion within the third quarter of 2020, up 140 percent growth year-over-year. As of January 2021, market capitalization of mobile payments service surpassed \$100 billion, with a stock value at more than \$200 (Square, 2021).

Trading for e-commerce platform Etsy, while its debut in IPO in 2015, was around \$31 per share followed by dramatic decline to below \$9 in the following months. A number of investors doubted if e-marketplace company would endure in the industry mainly characterized by the giants such as eBay and Amazon. In addition, there was raised the issue of counterfeit goods that was reported

in 2015 up to 2 million merchandise traded on the marketplace might offend trademark regulatory policy. However, despite earlier pessimism, Etsy continued to improve and expand steadily. Within three-year period from 2015 to 2018, Etsy's earnings surged 120 percent and revenue per stock climbed to \$0.62. Later on, the company's worth experienced the considerable rise in 2021: value per share soared to above \$200, revenue in the 3d quarter elevated to \$532 million (Benzinga, 2021).

Company valuation approaches.

Financial institutions devote a significant amount of effort to assess the value of a business that is about to go public. Eventually

the investors will be the ones who solely determine the company's worth once they opt to join the offerings and trade shares after business starts being marketed. When they take the necessary actions towards valuing a company before it comes public, they attribute to the following primary approaches:

- Financial modeling (discounted cash flow "DCF" appraisal);
- Comparable company analysis;
- Precedent transaction analysis.

Using these three tools, bankers can gauge what, they believe, is a realistic price that investors would be prepared to spend for a firm.

Financial modeling.

As emphasized above, to estimate the value of business and anticipate its financial success in the future, one can refer to the tool of financial model. The analysis is basically focused on the past performance of the company and future forecasts. Moreover, it necessitates the preparation of a cash flow statement, balance sheet, income statement and associated

documents. One can develop further complex models from there such as leverage-buyout analysis (LBO), discounted cash flow (DCF) estimation, sensitivity study and mergers and acquisitions analysis (M&A).

Comparable company analysis.

This is a method for determining a company's worth by comparing its statistics to those of other companies in the same sector of equal size. The concept of comparable company research is that similar firms will have similar value ratios, such as EV/EBITDA (Investopedia, 2021). Experts find a set of accessible data for the companies under consideration and compute value ratios to start comparing them. One can include the following metrics to be widely employed within evaluation into comparable company analysis: price to earnings (P/E), price to sales (P/S), enterprise value to sales (EV/S) and price to book (P/B).

Precedent transaction analysis.

It is a tool of valuing a company in which previous mergers and acquisitions activities are applied for a comparable company

valuation. This type of assessment is frequently referred to as “precedents” and is widely developed by researchers engaged in venture capital, investment banking and corporate strategy when endeavoring to evaluate an entire company as aspect of M&A. Key factors affecting business value before IPO.

Focusing on key aspects that significantly impact on how prospective buyers view the company is the greatest approach to develop or preserve business value and make it closer to fair value. These aspects include:

- Negative events and operating losses that were reported in the previous periods of the company's financial and economic activities;
- Determining the need for additional funding;
- Industry trends;
- Taking into account current and potential competitors in the industry;
- Dependence of the company on new customers, suppliers, product;

- The impact of the regulatory framework;
- Change of technologies in the IT-sphere;
- Country risks.

RESULTS AND DISCUSSIONS.

Optimization measures of company's value management.

Taking into account the circumstances above, one can consequently develop the following measures that management can apply in order to improve the firm's value and motivate potential investors to invest their money when company goes public:

- Increase in the share of dividends paid. Such practice is wide spread among Western «mature» companies (Chevron, ExxonMobil, IBM, Coca-Cola, AT&T, PepsiCo, Procter & Gamble, Walmart, etc.). The constantly growing level of dividends raises company's image and makes it more attractive in the eyes of investors. However, it is worth to note here that decision of increase in the dividends paid mostly depends on how well the company is

doing and whether it faces losses. In this case, one does not count on dividends but there are exceptions. For instance, sometimes management decides to pay dividends from retained earnings of previous years or take a loan for this.

- Develop a system of enterprise's value factors from the most to the least important. To be more precise, since the company's value is constantly subject to changes under the impact of both internal and external factors, company's management should correctly set the priorities and determine the key factors of enterprise's value. Largely depending on that, one achieves success in reaching strategic goals in managing and optimizing the value of the company. As an example, it is necessary to form a "tree" of firm's value factors and, by relying on the influence extent, give the priorities, which improves management efficiency and helps to identify the drivers of company's value. As in certain case, most influence on value comes from vital few indicators,

so-called Pareto principle is observed.

CONCLUSION

To sum up, the issue of company's value within prior-IPO-stage has been particularly elaborated and evaluated. On this path, one defined IPO term, described its role in company's certain lifecycle and clarified its emerging importance in the Republic of Uzbekistan, including numerous governmental decrees and regulations towards liberalization of economy and establishing favorable conditions. Moreover, the examples of undervalued and overvalued companies were provided to give a clear picture of actuality and substance of investigated issue. Prior company goes to IPO, one uses the different approaches to assess the enterprise which were explored in the paper. Having considered the main factors that influence on firm's value, one proposed and developed optimization measures of company's pre-IPO value management. Taking into account all above, one can note that before going public, company's management should not forget about the

likely consequences, which are often caused by overestimation of the business value. Despite the strong desire to overestimate it, one should not resort to these measures. Thus, the fair value of the company will more closely reflect the market expectations of investors and will allow the company to successfully place its shares, and hence achieve the goals and objectives set by the top management of the company.

REFERENCES

1. Aggarwal, R., Bhagat, S. and Rangan, S., 2009. The Impact of Fundamentals on IPO Valuation. *Financial Management*, 38(2), pp.253-284.
2. Benzinga. 2021. Earnings Calendar as of Nov 15 and Recent Earnings News • Benzinga. [online] Available at: <<https://www.benzinga.com/calendars/earnings>> [Accessed 15 November 2021].
3. Bloomberg. 2018. Xiaomi's IPO Raises \$4.7 Billion After Pricing on Low End. [online] Available at: <<https://www.bloomberg.com/news/a>rticles/2018-06-29/xiaomi-ipo-is-said-to-raise-4-7-billion-after-low-end-pricing> [Accessed 22 September 2021].
4. Bloomberg. 2019. Wanda Sports Has Year's Second-Worst Debut After IPO Flops. [online] Available at: <<https://www.bloomberg.com/news/a>rticles/2019-07-26/wanda-sports-keeps-falling-after-ipo-falls-far-short-of-target> [Accessed 27 August 2021].
5. Bloomberg. 2020. Xiaomi's Stock Surge a Big Reversal After Post-IPO Struggles. [online] Available at: <<https://www.bloomberg.com/news/a>rticles/2020-08-28/xiaomi-s-stock-surge-a-big-turnaround-after-post-ipo-struggles> [Accessed 25 September 2021].
6. Bochner, S., Avina, J. and Cheng, C., 2016. *Guide to the Initial Public Offering*. 8th ed. St. Paul, Minn.: Merrill Corp., pp.3-16.
7. CB Insights Research. 2021. *How To Value A Company: An In-Depth Guide To*

- The Business Valuation Process - CB Insights Research. [online] Available at: <<https://www.cbinsights.com/research/report/how-to-value-a-company/>> [Accessed 22 September 2021].
8. Corporate Finance Institute. 2021. Initial Public Offering (IPO). [online] Available at: <<https://corporatefinanceinstitute.com/resources/knowledge/deals/ipo-initial-public-offering/>> [Accessed 21 September 2021].
9. Debter, L., 2019. SmileDirectClub Gets Chilly Reception In Latest Billionaire-Minting IPO. [online] Forbes. Available at: <<https://www.forbes.com/sites/laurendebter/2019/09/11/smiledirectclub-ipo/?sh=fb62b5f6aca3>> [Accessed 29 September 2021].
10. GlobeNewswire. 2020. Wanda Sports Group Company Limited Reports Third Quarter 2020 Results. [online] Available at: <<https://www.globenewswire.com/en/news-release/2020/12/01/2137317/0/en/Wanda-Sports-Group-Company-Limited-Reports-Third-Quarter-2020-Results.html>> [Accessed 20 September 2021].
11. Investopedia. 2021. How an Initial Public Offering (IPO) Is Priced. [online] Available at: <<https://www.investopedia.com/articles/financial-theory/11/how-an-ipo-is-valued.asp>> [Accessed 18 September 2021].
12. Lex.uz. 2021. PF-4947-son 07.02.2017. O'zbekiston Respublikasini yanada rivojlantirish bo'yicha Harakatlar strategiyasi to'g'risida. [online] Available at: <<https://lex.uz/docs/-3107036>> [Accessed 12 September 2021].
13. Lex.uz. 2021. PQ-4124-son 17.01.2019. Kon-metallurgiya tarmog'i korxonalari faoliyatini yanada takomillashtirish chora-tadbirlari to'g'risida. [online] Available at: <<https://lex.uz/docs/->

- 4168220> [Accessed 17 September 2021].
14. Lex.uz. 2021. 268-son 10.05.2017. Fond birjasida aksiyalarni ommaviy taklifini o'tkazishni tashkil etish to'g'risida. [online] Available at: <<https://lex.uz/docs/-3200315>> [Accessed 18 September 2021].
15. Lex.uz. 2021. 358-son 26.04.2019. Fond birjasida aksiyalarning birlamchi va ikilamchi ommaviy takliflarini o'tkazishni tashkil etish to'g'risida. [online] Available at: <<https://lex.uz/docs/-4312349>> [Accessed 17 September 2021].
16. Square. 2021. Square Inc. - Financials - Quarterly Results. [online] Available at: <<https://investors.squareup.com/financials/quarterly-results/default.aspx>> [Accessed 9 October 2021].
17. Statista. 2021. Company valuation before IPO in the U.S. 2000-2020 | Statista. [online] Available at: <<https://www.statista.com/statistics/914614/median-valuation-before-ipo/>> [Accessed 28 August 2021].
18. Sun, Z., 2021. Is SmileDirectClub Stock a Buy? | The Motley Fool. [online] The Motley Fool. Available at: <<https://www.fool.com/investing/2020/06/08/is-smiledirectclub-stock-a-buy.aspx>> [Accessed 17 September 2021].
19. U.S. Securities and Exchange Commission (SEC). 2021. Investing in an IPO | U.S. Securities and Exchange Commission: Office of Investor Education and Advocacy. [online] Available at: <<https://www.sec.gov/files/ipo-investorbulletin.pdf>> [Accessed 15 August 2021].
20. Walton, J., 2020. When Did Facebook (Meta) Go Public?. [online] Investopedia. Available at: <<https://www.investopedia.com/ask/answers/111015/when-did-facebook-go-public.asp>> [Accessed 19 August 2021].