Netscape

Executive summary

The main concern in the case revolves around the decision-making process involved in setting the initial price for Netscape's IPO. Specifically the dilemma to whether Netscape should adhere to the initial offering price of $14 or follow the suggestion to double the price to $28, given the strong interest from the roadshow. Based on our analysis we recommend the Board of Netscape to not only double the offering price but to increase it even further, as our DCF analysis yielded a share price of $31.75. The main value drivers in our valuation of Netscape are the strong revenue growth, due to the underlying positive trend of new online users worldwide from 1986 to 1995 (ourworldindata, 2024) as well as the realization of more cost efficiencies during the maturing phase of Netscape.

Four recent IPOs

In our search for four companies with an IPO like Netscape within the timeframe of March 2023 to February 2024, we have identified the following four companies: Alpha Technology Group, Global Mofy Metaverse, Linkage Global, and Klaviyo. It is challenging to find companies with the same characteristics as Netscape, considering it has been nearly 30 years since the company went public, and there has been a great deal of innovation within the technology sector during that period. However, the peers identified share similar attributes as Netscape such as operating in the technology sector, have uncertain cash flows, and in the case of Alpha Technology Group and Global Mofy Metaverse, had a very short lifespan as a company before going public. Exhibit 1 shows instances of both underpricing and, in the case of Linkage Global, an overpricing.

Mechanism behind their IPO process

Alpha Technology Group's IPO was conducted on a firm commitment basis by Prime Number Capital LLC, with legal counsel from Hunter Taubman Fischer & Li LLC and Sichenzia Ross Ference Carmel LLP. For Global Mofy Metaverse, Prime Number Capital LLC acted as the sole bookrunner, managing book-building and coordinating investor orders, and utilized an greenshoe option for an additional 40'000 shares at $5.00 each to manage demand and stabilize the post-listing share price. The IPO details were provided in a Form F-1 declared effective by the SEC. For Linkage Global, EF Hutton LLC, as the lead underwriter, was obliged to buy all shares in the IPO before selling them to the public, assuming the risk of distribution. The IPO was priced at $4.00 per share, with total gross proceeds of $6'000'000, excluding underwriting discounts and issuance expenses, and included a 45-day option to purchase up to 225'000 additional shares to manage excess demand. Klaviyo's IPO was managed by Goldman Sachs, Morgan Stanley, and Citigroup as bookrunners, employing a firm commitment contract to build a book of orders during the pre-IPO roadshow to ensure awareness of public listing risks, with the IPO price set at $30.

IPO Recommendations and SPAC

Looking at the current market situation, S&P Global observes a global decrease in IPOs and public funding due to high uncertainties in the market of interest rate changes. Given the current market conditions, the likelihood of under-subscription is high, and the price underlies higher volatility. Therefore, a firm commitment contract allowing the underwriter to break the syndicate in the case of under-subscription is unfavorable for the firm as well as for the investment bank. Alternatives such as going public via a Special Purpose Acquisition Company (SPAC) or a direct listing of current shareholders allow for less price volatility in an uncertain market. Since the first SPAC was used in 1993, it was a new method for an IPO and not as trending as in recent years. Due to that reason, finding a SPAC for going public could be a first hurdle for Netscape in 1995. Nevertheless, using a SPAC could have been beneficial for Netscape by preventing the switch in the offering price one day before their IPO date. Since SPACs fix the transaction price already before the closing, price uncertainty could be eliminated in contrast to the traditional IPO process, where the price is fluctuating until the closing. Further advantages for Netscape we see in the time to market, since M&A transactions can be executed within a timeframe of 3-6 months, while traditional IPOs can take up to 1 year to go through and are more costly too. By decreasing the timeframe of the transaction, Netscape can focus faster on their core business and decrease the amount of fees from investment banks and advisors, which can be crucial for a currently cash-burning company.

Netscape's IPO Funding Requirements

Netscape is a rapidly growing new company in a competitive landscape. For companies like Netscape it is crucial to have available capital in the growing phase to take investment projects, increase R&D and meet obligations. Before the IPO, Netscape needs to know how much money they need to gain. In June 1995, Netscape had a total of $26m in liabilities and $128’000 in interest expenses. The $15m deferred revenues among the liabilities do not constitute interest-bearing debt, thus contributing to the observed low interest. We assume that Netscape would raise enough equity to cover their interest obligations for the next five years, and that the interest expenses are unchanged, because it is not common to issue new debt while you are issuing an IPO. In addition, companies usually don't pay down their debt while having a negative net income. Based on these assumptions Netscape needs 1’280’000 to cover interest expenses. The capital raised in the IPO, should be able to cover the deficit in the future estimated cash flows. We discount the FCF for the next five years and find that Netscape needs to raise $38’825’000 to cover the negative cash flows. The underwriters of the IPO take a 7% sale commission for all the shares sold to initial investors. The offering price of $28 with 5m shares offered, gives a fee of $9m. Based on these calculations Netscape has to raise approximately $49m from the IPO. This estimate appears justified given that the IPO with the original offering price was anticipated to generate $49m.

Alternative Capital Sources Beyond Public Equity

There are other alternatives to raise capital outside the public equity markets. Netscape could use debt financing, issue preferred stocks or seek investing from venture capital or private equity. Despite Netscape's existing debt financing, additional capital could be sought through bank loans. The appeal of bank financing lies in the ability to provide immediate capital infusion without necessitating dilution of ownership. However, it is noteworthy that for a tech company like Netscape, reliant primarily on intangible assets, the risk of financial distress is heightened. These characteristics of intangible asset-heavy companies may render loans more costly due to increased perceived financial risk. Netscape in its early growing phase, is poised for potential funding from venture capital firms specializing in high-growth technology, with private equity companies also expressing interest. Both VC and PE prefer equity stakes for funding, offering Netscape access to capital, strategic guidance, and network opportunities. Considering funding outside equity markets, venture capital emerges as a favorable option, given its specialization in early stage companies and typically lesser ownership stake requirements compared to private equity

Revenue trajectory and key valuation indicators

The primary driver of value in the valuation model is the anticipated revenue growth. The modeled growth rate decline is designed to reflect the standard progression of a company as it matures, where the perpetual growth rate of 3.5% reflects the point at which the company reaches maturity. For the purpose of our analysis and to accurately represent a full year’s revenue, we have chosen to double the reported revenue in the income statement for 1995. The initial 1995 growth rate is set slightly above Microsoft’s first-year post-IPO growth of 75% in 1986-87. This is attributed to the significant increase in global internet users from 1986 to 1995 and as well as realising more cost efficiencies in the maturing face of Netscape. Netscape requires a 48% annual growth from 1995 to 2005 to justify its $28 per share offering price, indicating a 11% underpricing compared to our $31.75 valuation. The WACC of 11,56% is used as a discount rate to match the consistency with the cashflows to all investors and reflects the risk associated with a company’s operations and investments. We have chosen to use an adjusted beta of 1.239 from Bloomberg. Here, we have chosen to base our analysis on Microsoft's (MSFT) beta, considering the similar business model and similar products, from the time they went public in 1987 until the year Netscape was listed on the stock exchange in 1995.

Bibliography:

Hannah Ritchie, Edouard Mathieu, Max Roser and Esteban Ortiz-Ospina (2023) - "Internet". Published online at OurWorldInData.org. Retrieved from: 'https://ourworldindata.org/internet' [Online Resource]

Appendix

Exhibit 1:

Company	IPO-price	Change ($)	1. day close	Change (%)	Mispricing	IPO-date	Sector
Alpha Technology Group	4	0,4	4,4	10%	Underpriced	31. oct. 23	Cloud-based IT services
Global Mofy metaverse	5	0,1	5,1	2%	Underpriced	10. oct. 23	Metaverse
Linkage Global	4	-0,88	3,12	-28,2 %	Overpriced	19. dec. 23	E-commerce
Klaviyo	30	2,7	32,7	9%	Underpriced	20-Sep-23	Software platform

Exhibit 2:

		Terminal growth				
		1.50%	2.50%	3.50%	4.50%	5.50%
WACC	9.35%	37.71	42.63	49.23	58.56	72.73
	10.35%	31.09	34.60	39.13	45.21	53.81
	11.35%	25.94	28.52	31.75	35.93	41.54
	12.35%	21.85	23.79	26.17	29.16	33.01
	13.35%	18.54	20.03	21.82	24.02	26.78

Exhibit 3:

FREE CASH FLOW TO THE FIRM	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Revenues	$ 33 250 782	$ 63 176 486	$ 114 570 557	$ 197 863 352	$ 324 594 829	$ 504 420 364	$ 740 236 884	$ 1 022 267 137	$ 1 323 324 809	$ 1 598 576 369	$ 1 792 803 398
COGS	-3 391 580	-6 444 002	-11 686 197	-20 182 062	-33 108 673	-51 450 877	-75 504 162	-104 271 248	-134 979 131	-163 054 790	-182 865 947
R&D	-12 369 291	-23 501 653	-42 620 247	-73 605 167	-120 749 276	-187 644 375	-275 368 121	-380 283 375	-492 276 829	-594 670 409	-666 922 864
Other operating expenses	-25 603 102	-42 749 422	-66 832 825	-96 953 042	-128 755 949	-153 007 510	-155 449 746	-214 676 099	-277 898 210	-335 701 038	-376 488 714
EBITDA	**-8 113 191**	**-9 518 591**	**-6 568 712**	**7 123 081**	**41 980 931**	**112 317 601**	**233 914 855**	**323 036 415**	**418 170 640**	**505 150 133**	**566 525 874**
Depreciation	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	-1 352 209	0
EBIT	**-9 465 400**	**-10 870 800**	**-7 920 921**	**5 770 872**	**40 628 722**	**110 965 392**	**232 562 646**	**321 684 206**	**416 818 431**	**503 797 924**	**566 525 874**
Opening Balance	12 090 000	21 555 400	32 426 199	40 347 120	35 730 423	**3 227 445**	**0**	**0**	**0**	**0**	**0**
Current loss	9 465 400	10 870 800	7 920 921	0	0	0	0	0	0	0	0
Subtotal	**21 555 400**	**32 426 199**	**40 347 120**	**40 347 120**	**35 730 423**	**3 227 445**	**0**	**0**	**0**	**0**	**0**
Loss used	0	0	0	4 616 697	32 502 978	3 227 445	0	0	0	0	0
Closing balance	21 555 400	32 426 199	40 347 120	35 730 423	3 227 445	0	0	0	0	0	0
Tax (35%)	0	0	0	0	-2 844 011	-37 708 281	-81 396 926	-112 589 472	-145 886 451	-176 329 273	-198 284 056
NOPAT	**-9 465 400**	**-10 870 800**	**-7 920 921**	**5 770 872**	**37 784 712**	**73 257 111**	**151 165 720**	**209 094 734**	**270 931 980**	**327 468 650**	**368 241 818**
Depreciation	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	0
CAPEX	-14 623 694	-24 032 335	-36 777 149	-51 761 053	-65 633 074	-72 031 228	-61 735 756	-81 781 371	-105 865 985	-127 886 110	-143 424 272
Increase in WC	-	-	-	-	-	-	-	-	-	-	-
FCFF	**-22 736 885**	**-33 550 926**	**-43 345 861**	**-44 637 972**	**-26 496 154**	**2 578 092**	**90 782 173**	**128 665 572**	**166 418 204**	**200 934 750**	**224 817 546**
Cumulative FCF (Break-even)	-22 736 885	-56 287 810	-99 633 671	-144 271 643	-170 767 797	-168 189 705	-77 407 532	51 258 040	217 676 244	418 610 994	643 428 540

Exhibit 4:

Assets	December 31, 1994	June 30, 1995
Cash and short-term equivalents	3'243'510	8'868'436
Short-term investments	-	16'567'300
Accounts receivable	701'649	8'277'869
Other current assets	67'284	804'971
Total current assets	**4'012'443**	**34'518'576**
Net PPE	2'447'098	6'761'045
Deposits and other assets	699'100	1'251'582
Total assets	**7'158'641**	**42'531'203**
Liabilities and Stockholders' equity		
Accounts payable	855'068	4'607'174
Accrued compensation and related liabilities	527'340	1'075'066
Other accrued liabilities	667'503	1'897'819
Deferred revenues	2'575'145	14'963'843
current portion of long-term obligations	725'000	725'000
Installment notes payable	-	551'449
Total current liabilities	**5'350'056**	**23'820'351**
Long-term obligations	725'000	725'000
Installment notes payable	-	1'511'331
Total liabilities	**6'075'056**	**26'056'682**
Preferred stock, $0.0001 par value	701	901
Common stock, $0.0001 par value	451	1'514
Additional paid-in capital	9'552'278	39'683'666
Notes receivable from stockholders	-	-638'065
Deferred compensations	-	-9'812'151
Accumulated deficit	-8'469'845	-12'777'561
Accumulated translation adjustment	-	16'217
Total Stockholders' equity	**1'083'585**	**16'474'521**
Total liabilities and Stockholders' equity	**7'158'641**	**42'531'203**

Exhibit 5:

Assumptions and input	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Revenue growth rate	90%	81,4%	72,7%	64,1%	55,4%	46,8%	38,1%	29,5%	20,8%	12,2%	3,5%
Total cost (% of revenue)	10,20%										
R&D (% of revenue)	37,20%										
Other operating expenses (% of revenue)	77,00%	67,67%	58,33%	49,00%	39,67%	30,33%	21,00%	21%	21%	21%	21%
CAPEX (% of revenue)	43,98%	38,04%	32,10%	26,16%	20,22%	14,28%	8,34%	8%	8%	8%	8%
Depreciation (6,761,045 * 2)	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	1 352 209	0
Changes in NWC	-	-	-	-	-	-	-	-	-	-	-

Exhibit 6:

Assumptions and input	
Growth rate (g) after 2005 (3,5%)	3.50%
Risk-free rate	6.15%
Effective tax rate	35.00%
Market risk premium	5.50%
Beta	1.239
Cost of equity	12.96%
Cost of debt	6.15%
Debt/capital	0.18
Equity/capital	0.82
WACC	11.35%
Shares outstanding	33'001'000