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Floats and expectations: what the market can learn from iSelect's troubled IPO

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Health insurance infomediary iSelect saw a 15% decline in its share price immediately after listing on the ASX in June. AAP/Paul Miller

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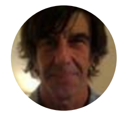

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Insurance infomediary iSelect lost its chief executive this week, just four months after the company went public, and less than two years into the role.

iSelect blamed the resignation on a "difference of opinion" between the CEO and the company's board, but it also comes after a probe by the Australian Securities and Investments Commission into revenue forecasts made by the company in its prospectus.

iSelect's business model is based on the idea that consumers deserve informed choice. On the face of it then it has a lot in common with what the Corporations Act wants for investors.

Section 710 of the Act sets out the information a prospectus must contain in order to give investors the ability to make an "informed assessment" of the assets and liabilities, financial position and performance, profits and losses and prospects' of the company.

Important here is the issue of a company's prospects. To investors, prospectuses, including forecasts, are a key factor, however they are often difficult to gauge. This is why the regulation of fundraising in Chapter 6D of the Corporations Act is crucial in protecting investors from the downsides of inadequate disclosure and ensuring information provided is clear and meaningful.

Both prospectuses, and company performance, do not always live up to expectations.

Forecasts are just that

There is a market truth behind iSelect's disclaimer in its prospectus that "there is no guarantee that the forecast financial results will be achieved".

In a recent update the company announced group revenue of A$118m, 2.9% below its prospectus forecast of A$121.6m. It has also advised that revenue for the 2013 calendar year is expected to be A$126.5m, which is also below the prospectus forecast of A$132.5m.

The Corporations Act dictates that forecasts in prospectuses must not be misleading or deceptive. Forecasts are not required in every instance but market pressure makes some element of forecasting fairly crucial.

Although iSelect has failed to meet its prospectus revenue forecast it has nonetheless been a success story since it began operating 13 years ago. But almost immediately after it had listed in June its shares were trading at a significant discount to the issue price of A$1.85. Here it is in good company – Myer has not got anywhere near to its listing price since its IPO in late 2009.

There is a possible similarity between the two floats in that both companies generate positive consumer responses, Myer has its loyal customers, and iSelect has had a very strong media presence through constant advertising. In such cases the question must arise as to whether prospectuses are enhanced by perception.

What's reasonable

It is reasonable to expect that when companies list they will be at their strongest, their muscles flexed and ready for the challenges ahead. Substantial and costly investigation and advice goes into a prospectus and this would suggest that it should provide more than hope, it should be precise and forecasts solid. Whatever risks are disclosed they will always be outweighed in the prospectus by benefits. But investors should not need to be told that predicting share prices is not an exact science.

Reliable information on the financial prospects of companies, particularly those in the process of raising capital is critical for investor confidence. Where such information is absent ASIC can bring proceedings.

The Notice Requiring the Production of Books served on iSelect in September is a tool that can be used by ASIC to investigate market concerns, particularly as to whether adequate disclosure has taken place. The information required by ASIC went not only to iSelect's 29 August announcement which reaffirmed its EBITDA forecast but also to the period prior to the IPO.

Clarifying the company's links to health insurance group NIA Health, the poor post-float trading price, the reappraised forecasts and divergence between assumptions relevant to the prospectus and the 29 August announcement are matters that may have been relevant to ASIC in its appraisal.

The recent resignation of iSelect CEO Matt McCann, and the costs associated with his departure have added controversy. McCann had led iSelect into and through the listing process, but reports suggest his departure was related to differences in future directions for the company.

Were these differences apparent at the time of the IPO or did they materialise when the share price went rapidly downhill thereafter?

Future prospects

The company acknowledged in its prospectus "the loss of any key staff" as an issue that could hamper its ability to achieve its strategic growth objectives and its financial performance forecasts.

Interestingly the departure of the CEO coincided with a trading update and a slightly better share price. However, for all of the detail and disclaimer evident in the prospectus and all of the regulation and requirements evident in the law, in the end circumstances may prevail and caveat emptor apply. Sometimes good companies float to sink a little.

The other aspect raised by ASIC with iSelect related to the continuous disclosure provisions of the Corporations Act. As has become increasingly obvious ASIC has stepped up its interest in policing sections (674 and 710) of the Act that target the value of the company's securities.

Investors can only make informed decisions as to a company's worth if all relevant information is available and current. Both sections go to corporate governance and both place responsibility on directors.

At present it seems iSelect has responded to ASIC's initial concerns. However the wider puzzle of the shiny, confident prospectus and the immediate market reappraisal of share value remains.

IPOs Governance ASIC Continuous disclosure