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The Contrarian Take: Groupon's S-1 Is Pretty Great, Actually.

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Editor's Note: *The following is a guest post written by Kyle Doherty, an early-stage information technology investor at Morgenthaler Ventures and, importantly for the content below, not an investor in Groupon.*



Ever since Groupon filed to go public, tech pundits have had a field day deriding the company for everything from an all-too-easy-to-imitate business model to non-existent profits, accounting gimmicks, unfair deals to merchants, excessive cashing out by its management, and even the “checkered past” of its chairman. I write not to debate those points, but to say, if you look at their S-1 as a stand-alone registration document, it’s pretty darn good. In fact, having read hundreds of S-1s and 10-Ks as an equity analyst at Morgan Stanley and Thomas Weisel, I would say it stands as one of the best I have read.

S-1s, like many legal documents, are seemingly written in code. Let me offer my personal checklist on how to read an S-1 to quickly surmise the prospects of a company; understand the most common misperceptions; and make your own judgments when reading the anticipated filings of other high-profile Internet companies such as Zynga (which will reportedly file tomorrow), Facebook and Twitter.

What's to Like

[Groupon's S-1](#) set the right tone immediately. My favorite part of the entire 263-page document is the introductory letter by Andrew Mason, Groupon's CEO. It is succinct, informative and funny. (I would not be surprised if their famous [copywriting](#) staff had something to do with it.) It conjures up the same straight-talking, irreverent, "don't be evil" spirit as the [letter from Google](#) co-founders Larry Page and Sergey Brin included in Google's S-1. It fills out the highly-regulated, obligatory form in a way that gives you a sense of their culture, corporate values and personality.

Groupon's S-1 provided a level of clarity and transparency that is a breath of fresh air. The company took a fair amount of heat for its use of a non-GAAP financial measure: adjusted CSOI (consolidated segment operating income). To be fair to the company, use of non-GAAP financial measures is standard practice on Wall Street, particularly for companies that do not currently show profitability on a GAAP basis. I laud Groupon for being up-front about the metric they believe to be important for valuation. What is standard practice on Wall Street may not fly anymore (for good reason), but the thinking behind justifying proxy metric valuations remains prevalent. Indeed, many companies slyly encourage sell-side and buy-side analysts to focus on metrics excluding "non-operating" expenses like stock-based compensation without stating it explicitly in public filings.

What is an S-1?

It may be helpful to step back and start at square one. An S-1 is a legal document filed by public companies to register their securities with the U.S. Securities and Exchange Commission (SEC). It commonly includes a description of the company's business, financial statements, biographies of

officers and directors, detailed information about their compensation, any litigation that is taking place, and a summary of material information. It is one of the main documents used by investors to research a company prior to an initial public offering (IPO). Often, an S-1 is the first, most meaty, introduction of the company to the investment world.

How to Read an S-1 in 5 Minutes

S-1s contain standard information required by the SEC. They are long, tedious and dangerous to read if you have a sleep deficit. Concentrate on the following sections for a quick take on a company's financial health and business outlook:

- *Cover page.* This page warrants nothing more than a quick glance. Below the flashy corporate logo is information about the registration of the equity security, including ticker symbol, class of offering, size of the offering and expected price. However, the most exciting part of the cover page is at the bottom where the banks are located. Investment banks fight tooth and nail to get placement in the top line of the listing, and then poke eyes out to be placed on the left. This has implications for how much of the economics they will see, but more importantly it signals the pecking order of the banks running the deal. In Groupon's filing, Morgan Stanley is LeBron James, Goldman Sachs is Dwayne Wade, and Credit Suisse is Chris Bosh. All three are necessary to execute the IPO.
- *Prospectus Summary.* If you are time constrained, read just this section to quickly get up-to-speed on the company. The prospectus summary contains information that is elsewhere in the filing, but presented with just enough depth to get a very solid understanding of the business, the security offering, consolidated financial information and the important metrics. If you want to dig in more deeply, you can skip this section.
- *Selected Consolidated Financial and Other Data.* This part of the S-1 is for finance geeks and accountants (hey, I get excited about it). This is where one can glean revenue performance, margins, profitability, and cash flows.
- *Management Discussion and Analysis of Financial Condition and Results of Operations.* This section is important but again more key for financial analysts because it contains the bulk of information regarding

business metrics and the nitty-gritty details in the financial statements (it typically goes through each line item of income statements, balance sheet, and statement of cash flows). Beware the data overload!

- *Business.* This part of the Groupon S-1 was a crowd favorite with colorful pictures and website screen shots. When first getting acquainted with a company, spend most of your time here. You'll get a more precise idea of what the business is, what products and services are offered, and how that ties into the revenue model. Groupon pulled this off very well by answering questions about its business model and providing insight into subscriber and geographic economics. It ended up as a double-edged sword however: the case studies provided great detail but also led quite a few to raise questions about the sustainability of the business.

- *Risk Factors.* This is a section that I typically skip or read very quickly. Many of the key risks are fairly straightforward – if not obvious (“We may not sustain the revenue growth we have experienced since inception” for example). However, risk factors become more interesting over time in the 10-K filings as sections are added, which can be telling for what the management team views as a risk. Microsoft just included a section titled “the cloud-based computing model presents execution and competitive risks” for the first time in their 10-K filing last July.

- *Principal and Selling Stockholders.* This is an important section to peruse, and not just so you know how many JetStream airplanes the founders will be able to purchase once liquid. Many investors in the public offering want to know who is selling, and how much – important social proof to signal to new investors that growth prospects remain strong. It stands to reason that a fund investing for the long term would want to make sure the important principals aren't jumping ship immediately (or even after the lock-up periods expire) and are committed or properly incentivized to grow the business over time. Typically, insiders (management and venture capitalists) hold back on selling shares in the IPO and instead opt for standard lock-up periods.

Common Misperceptions

Bloggers and press had fair and legitimate concerns after reading Groupon's S-1. But some of them were based on a misreading of the Risk Factors section. Remember a lot of lawyers are involved in writing an S-1. To cover their bases, the authors will throw everything and the kitchen sink in the Risk Factors section to satisfy SEC requirements of what might be considered "material" to a business.

Also, keep in mind that all financial results in the S-1 are backward-looking. Valuation is almost always based on expectations for future performance. Unfortunately, this is never published in filings but instead conveyed on the road show or through sell-side analysts, so most investors are not privy to what Groupon management believes will happen. Without really knowing this, most investors will unfortunately have an incomplete view of the promise of Groupon Now, its international strategy, and other areas that will be debated going forward.

Now I know as well as the next guy that a good S-1 doesn't necessarily mean a good business. What is put in writing is inconsequential compared to what is actually delivered. I don't have a horse in this race but will nevertheless watch with interest as the race is run. Whether Groupon turns out to be "[Grouponzi](#)" or the next Amazon remains to be seen. I commend them, however, on an S-1 well done.

Kyle Doherty is on the information technology investment team at Morgenthaler Ventures, an early-stage venture capital firm. He focuses on investments in the mobile, financial services, health IT and consumer Internet sectors. Follow him [@kydoh](#) and [www.kydoh.com](#).