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PERSPECTIVE

Weighing the IPO decision

By Sara L. Terheggen

It would not surprise anyone to learn that more companies are staying private longer. While 2017 has seen an uptick in the number of IPOs, it has not produced the kind of activity hoped for particularly among unicorns. Going public is not an easy task and getting a company pre-IPO ready can be even more daunting. Pre-IPO readiness can take anywhere from 12-24 months before a company is ready to undergo the actual IPO process. Then, the actual IPO process can take anywhere from 3-6 months. Needless to say, it is a time consuming process and it is important to determine if an IPO is the best option before expending the time and resources to prepare to become a public company.

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Why Companies IPO

There are several reasons why a company would decide to go public. The primary considerations include liquidity (including both founder liquidity and investor liquidity), access and growth.

Liquidity, which includes both founder liquidity and investor liquidity, can often top the list of reasons why a company goes public. Monetizing an equity interest at rich price-to-earnings multiples that are typically available only in the public markets is certainly an attractive proposition. While a sale is another path to liquidity, the public markets typically offer a higher earnings multiple and, hence a higher enterprise value than any private purchaser is willing to pay. However, it can take years for the pre-IPO investors to sell out in full. Thus, when the public market valuation does not exceed the valuation available in a private sale, most founders and investors looking to exit will opt for a private sale since that does provide the benefit of getting out all at once. In the event there is uncertainty around valuation or which exit opportunity is the better option, a dual-track process can be a great alternative. Even though valuation can often rule the decision making process, there are founders who do not wish to sell their company outright to someone else and will opt for the IPO as a means for providing some liquidity without losing control. Founder objectives can play a significant role in a company's decision making process and can be in conflict with investor desires.

Another reason companies go public is access to public markets. Public markets provide a source for future financings. Being a public company can also be important for suppliers and customers depending on industry. Becoming a public company provides direct access in these ways and can provide a company with a certain amount of legitimacy in the market.

Finally, companies often choose to go public for growth. Being a public company provides the opportunity to more easily attract and reward key employees and directors by offering upside opportunity through stock-based compensation. Having public stock can also be an excellent acquisition tool.

Why Stay Private

Although going public can provide much needed liquidity, access and growth capabilities, it brings with it a number of challenges. The primary reasons companies choose to stay private include short-term performance pressure, regulatory regime and corporate concerns.

Because public shareholders can be extremely finicky and focused on short-term performance, public companies get enormous pressure to increase earnings. The quarterly reporting structures results in a constant focus on reporting results and shareholders are seeking constant increases in a company's stock price. This dynamic can impact company decision making by focusing on outcomes that will have short-term positive results with little regard for long-term objectives.

The regulatory regime is another challenging obstacle to going public. Public companies are subject to significant disclosure obligations whereby they are required to disclose extensive information, including but not limited to, the business and finances, executive compensation and transactions with insiders. Companies are obligated to disclose certain things even when this information could negatively impact the company or its stock price. The CEO and CFO will also be required to certify in periodic reports as to the adequacy of the company's disclosure controls and procedures and effectiveness of internal accounting.

Corporate concerns can be another factor weighing against the decision to go public. The existence of a large number of new shareholders to whom the board owes fiduciary duties and the enhanced regulatory scrutiny inherent in being a public company makes management more hesitant to undertake corporate actions. The regulations of the exchanges are also more stringent leaving companies with less flexibility in how they operate.

Decision Variables and Market Factors

Once a company has determined its objective and weighed the advantages and disadvantages of their options, it is also important to consider the interplay between the company's decision and market factors. If an IPO is contemplated, a company needs to assess their strengths as it relates to characteristics investors are typically focused on when investing in public companies. These include critically evaluating whether the company has a leading market position, compelling investment thesis, attractive financial track record, increasing or foreseeable revenue growth, strong management team and board and robust corporate governance. In addition to critically evaluating the potential reception of the market to the company, the market will also play a role in timing. For an IPO, the timing of the execution window can be critical and bankers will work closely with the company to find the ideal window to go out. If a company decides to pursue a sale, there is less concern about finding the right execution window but market forces can have an impact on potential buyers.

Weighing the Options

Evaluating whether to IPO is all about determining a company's objective. Going public is not for every company so it is important to determine your desired outcome and decide if going public is the best way to meet that objective. This includes weighing alternatives such as a private sale of the company's securities, bank financing, entering into corporate partnering arrangements or merger or sale of the company. Some companies are also just choosing to stay private longer and rely on private financings to fund ongoing growth. The company who realistically assesses both their internal and external readiness and invests the time necessary for the decision process has a higher likelihood of a successful outcome regardless of what decision is ultimately made.

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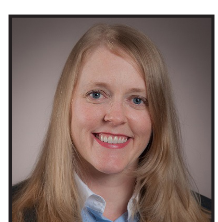

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