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PERSPECTIVE

Dual-track IPO process is gaining steam

By Sara L. Terheggen

Given volatile market conditions and increased uncertainty over finding the right magic window for execution of a successful initial public offering, the trend for companies undertaking a “dual-track process” (simultaneous launch of an IPO and merger and acquisition sale) is gaining momentum. In a recent Bloomberg study, 14 out of 52 companies (27 percent) withdrew their registration statements in 2016 and were acquired within six months of withdrawal. In 2015, this percentage was only 14 percent. Bloomberg reports that nearly one-fifth of companies that withdrew their IPO registration statements since January 2015 have announced a sale within six months of the withdrawal.

Use of the dual-track process is particularly popular with companies that are backed by private equity sponsors and venture capitalists. This may be due to the fact that dual-track companies can often squeeze a premium out of buyers if there is credibility in the IPO being pursued. Outlined below are the top two advantages and disadvantages that should be considered when contemplating a dual-track process, as well as some practical considerations to developing an execution strategy that will be successful.

ADVANTAGES

Leverage

Leverage is all about pricing and control. Pursuing both tracks can generate price tension through increased competition because beginning an IPO process provides a company maximum exposure in the market and uncovers prospective buyers. A 2010 analysis conducted by Brau, Sutton & Hatch found that dual-track companies saw a 22 percent to 26 percent premium over companies that only undertook one process. Following both paths also gives leverage over process in a potential acquisition. This is partly due to the fact that prospective buyers will be motivated to bid higher than each other as well as provide a better alternative to an IPO val-



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uation. This competitive process leverage helps to generate urgency and makes prospective buyers more amenable to executing on timelines dictated by the company.

Flexibility

This key advantage comes into play from both a market and strategy perspective. Pursuing two options in any context always provides more flexibility. Pursuing a dual-track path can help a company hedge against volatile market conditions and give a company greater flexibility to obtain the highest value at the right time. Strategically, the dual-track processes complement each other. Any corporate housekeeping that is done in connection with an IPO is also useful in a sale process and certain process efficiencies naturally result.

DISADVANTAGES

Management Fatigue

An IPO process is an extremely time consuming and burdensome process. A sale process is no less arduous. Trying to execute on both strategies at the same time can di-

vert management’s attention away from the business and create fatigue. While certain synergies can be generated between the two processes as discussed further below, each process still demands a certain amount of attention. Diverting management from the business can lead to problematic outcomes that can have a detrimental impact on the price and competitive advantage of the company.

Exposure

A dual-track process necessitates that the company has filed an IPO registration statement or has one ready to be filed. Public filing of a registration statement reveals all kinds of information about a company that a company may not want to reveal in the absence of actually becoming public. Also, disclosing the company story and financials may backfire. Prospective buyers may determine an IPO is the best alternative and may not pursue a sale process. Then, if the IPO ultimately fails, the exposure in the market could damage any future attempt the company may have at being sold or going public.

CONSIDERATIONS AND TACTICS

Each company will weigh the advantages and disadvantages differently depending on their business model, strategy, competitive advantage, market conditions and overall likelihood of success in either process. Management of a dual-track process is no easy feat and failure to develop a strategy from the outset could be problematic to both options. Below are some considerations to keep in mind when developing a strategy for dual-track success:

Investment Banks

Investment banks are a critical partner and key to identifying potential acquirers and advising on valuation.

Assess up front which investment banks will be involved and be clear about responsibilities and compensation at the outset to avoid unnecessary delays.

Most companies choose to have the lead

underwriter also serve as the M&A adviser to ensure neutrality as to what path is more desirable and to simplify the process.

Registration Statement

If an IPO seems more likely and the company is an “emerging growth company,” take advantage of confidential submission with the Securities and Exchange Commission and undertake one or more rounds of comments before initiating the M&A process.

If a sale seems more likely, consider preparing a complete registration statement but delay the filing as long as possible. The mere existence of the registration statement can inform potential buyers that a credible alternative exists.

If both tracks are equally likely to succeed, align the two processes and file the IPO registration statement at the same time as initiating the M&A process.

Confidentiality

Enforce comprehensive confidentiality agreements with prospective buyers and include a robust company standstill provision.

Avoid delivering the IPO registration statement to potential buyers until it is pub-

licly filed. Any entity that receives materials in connection with a potential acquisition cannot participate as a purchaser in the IPO.

Projections

A company will prepare a detailed set of projections (financial model) for the investment banks and research analysts in an IPO. The research analysts will also prepare their own financial model.

A company’s financial model can be shared with potential acquirers pursuant to the confidentiality agreement once the company is confident price indications are acceptable and interest is legitimate. However, the model prepared by the analysts should not be shared with potential acquirers.

Data Room

Diligence required by M&A buyers will be more extensive than that required to satisfy underwriter diligence. Work with advisors to develop a data room that will satisfy an auction process and then the company can easily pare that back for purposes of the IPO data room.

Maintain two separate data rooms to help maintain confidentiality since nonlead un-

derwriters should not know the M&A process is being conducted.

There is significant overlap between an IPO and M&A sale process and certain efficiencies can be obtained by executing a dual-track process. While a company must weigh the advantages and disadvantages to undertaking such an arduous process, attention to developing a strategy from the outset will make a significant difference in ensuring the success of executing a dual-track process and obtaining the best result for a company and its shareholders.

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