**Preparing for an Initial Public Offering (IPO)**

By Arthur F. Rothberg

Becoming a publicly-held company offers the owners of a private company the potential for substantial benefits. These include the ability to raise new capital for more rapid growth and to broaden ownership beyond the current owners. The process can also be used as an exit strategy for the founders or other current owners such as private equity investors, enabling them to extract the increased value of the enterprise.

A public listing also signifies that financial regulators have evaluated the company's financial and operating information, finding the company sufficiently viable for its shares to be sold to the public—although potential risks are always noted.

After the initial offering, the company can raise further additional capital through secondary stock offerings. Another benefit of going public is that a public company can often attract better talent by granting stock options that can appreciate in value assuming the company's profits and stock price rise over time.

**The IPO Process Has Become More Challenging**

Going public through an initial public offering (IPO) is not an easy process, and must be planned for in a methodical way to achieve the potential benefits of being a public company.

"Planning, executing, and managing an initial public offering is a challenging task for any organization, especially for its CEO and CFO. The better prepared a company is, the more efficient and less costly the process can be," says a report from PricewaterhouseCoopers summarizing a conference it held last year in Silicon Valley on "Getting Your IPO into High Gear."

But preparing for going public has become more burdensome and costly in recent years, as new laws and regulations have added to the requirements of becoming and remaining a public company. Laws such as the Sarbanes-Oxley Act of 2002 (SOX), which requires greater financial transparency, and the Dodd-Frank Act of 2010, which requires a wide range of changes for financial institutions and their customers, are examples of major legislation that significantly impacts public corporations.

These new laws, as well as the requirements of securities laws enacted in the 1930s and 1940s (and their later amendments), and many other laws and regulations, impose substantial obligations on publicly-held companies in terms of transparency, disclosure requirements, diversity requirements, etc., and the responsibilities of executives and directors and other company officials.

But despite the increased burdens placed on publicly-traded companies, when all is said and done, a large number of business owners continue to want to take their companies public for the substantial benefits available.

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**IPO Volume Follows Market Cycles**
The volume of IPOs typically rises and falls with trends in the overall market. When the markets are rising, the number of IPOs will rise, and vice versa. That has been apparent in the last several years, as the number of IPOs declined precipitously following the financial crisis, as well as during the market turmoil resulting from the U.S. debt ceiling showdown and the major financial problems in European countries.

Most companies will want to go public during a rising market, when the demand for new issues is higher, and they can command higher IPO share prices. Going public during a rising market typically means that the company can achieve higher premiums in early trading, offering the potential for continuing upward momentum going forward.

Nevertheless, some companies will take the plunge during a volatile market in order to get the growth capital they are seeking, despite the potential risks and the more difficult investment climate.

**Requirements for Listing**
A company that wants to be listed on an exchange will need to meet certain requirements as to its size, earnings level, and other variables. For instance, the NYSE requires that a company must have earned $10 million in pretax earnings over the past three years and more than $2 million in each of the past two years. If qualifying under the Income Standard Listing Rules, the NASDAQ Global Market requires that a company earn $1 million or more from continuing operations in the latest fiscal year, or in two of the past three years. The company and its attorneys must make sure that they meet these and other requirements of the exchange on which they wish to list.

**Meeting Investors' Expectations**
Like private investors, investors in public companies evaluate the investment in terms of the company's history, financials, management, strategy, product line, and a lot more. A solid management team is a key prerequisite. Often, entrepreneurs who founded a company may not be the right people to take it forward as a public company. The right management team for the IPO also presupposes a strong board of directors. Companies should make sure that excellent management and directors are in place, to maximize the ability to go public at the best possible price. Also, recent legislation (e.g., Sarbanes-Oxley) and regulations in the financial marketplace require that the board have certain "independent" directors—i.e., independent of company management—for the audit committee, and that the audit committee has a financial expert on board. The company needs to make sure that these requirements for the board are met.

**Engaging Investment Bankers and Attorneys**
Companies will need to engage appropriate underwriters/investment bankers to put the IPO deal together, as well as experienced securities attorneys to draft the prospectus and other required legal documents. Selection of investment bankers/underwriters should be done using a number of criteria, including experience with the specific industry, the ability to achieve substantial research and analyst coverage, and in general an appropriate sense of "fit" with company executives and personnel.

**Drafting the Prospectus**
Company executives, along with the investment bankers and attorneys, will draft the prospectus for the IPO stock offering. The CFO typically plays an extremely important role in putting the prospectus together. Based on securities laws and SEC regulations, the prospectus must include certain specific financial and other information about the business. In addition, the document should also be used to create a positive perception about the company's prospects and to appropriately position the company within its industry, and in general put the company in the best possible light for investors. The prospectus should incorporate the significant market opportunities available to the company, and the company's strategy to take advantage of the opportunities.

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### Filing the Prospectus and Reaching Out to Investors

The prospectus is filed with the SEC, which reviews it and then typically makes extensive comments and asks for more information before approval.

After approval by the SEC, the company typically organizes a "road show" to make presentations to prospective investors, and prints up the "reds" or preliminary prospectus to distribute to prospective investors. The "reds" show virtually the entire prospectus—except that instead of the final offering size and price, the expected offering size and expected price range are shown. The road show can be fairly local, or the company's executives, along with investment bankers/underwriters, investor relations specialists, etc., can travel to many locations to meet with a wide range of investors. The road show is perhaps the single most important aspect of developing a market for the new IPO. Investors want to meet and hear from key management, to make a first-hand evaluation of their capabilities.

In reaching out to potential investors, it is helpful to use both any internal public relations and investor relations specialists available, as well as to hire external specialists, to deliver the company's message to the investment community and securities analysts.

### Setting the Share Price and the Start of Trading

The share price for the IPO is typically set after the market close on the final day of the road show, and the offering trading begin the next day. Pricing should maximize the capital raised while at the same time not being so high as to be unattractive to investors. It is important to achieve a good performance on the day of the IPO, or the company may be subject to negative publicity.

### When Should You Go Forward?

The benefits of going public are substantial. But in turbulent markets such as we have been experiencing recently, the CEO and CFO of any private company should be cautious. In this market environment, only those companies that have an outstanding short- to medium-term term market opportunity can expect to maximize the potential benefits. For most, it might be better to wait for calmer seas and a more upbeat market environment.

Because of the complex requirements and time-consuming nature of going public, Los Angeles CEOs and CFOs should consider engaging with a CFO services firm that has substantial experience in taking companies public.

### References and Further Reading

Ernst & Young's Guide to Going Public. IPO Readiness: Going Public and Winning
http://www.ey.com/GL/en/Services/Strategic-Growth-Markets/Ernst---Youngs-guide-to-going-public---IPO-readiness--going-public-and-winning

Key Considerations in Preparing and Executing an IPO - A Summary of a Recent IPO Conference in Silicon Valley; PricewaterhouseCoopers; January 2010
http://www.pwc.com/us/en/transaction-services/publications/ts-insights/assets/preparing-executing-ipo.pdf

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