The Mechanics of Going Public in a Tough Market Environment

David A. Westenberg

The global financial crisis brought the IPO market to a near standstill from September 2008 through May 2009 (only eight IPOs in that nine-month period). While activity picked up in the last several months of 2009, investors remain skeptical of start-ups and many recent IPOs have not performed well in the public market. It appears that the financial crisis is having a lasting effect on new issues, and we wondered if the difficult conditions have changed the way in which a company must prepare to go public.

We spoke with David Westenberg, a WilmerHale partner and author of a recent book on the going public process, about whether and how the global crisis has changed the mechanics of completing an IPO.

The IPO landscape changed significantly as a result of the global financial crisis. What new challenges do pre-IPO companies face as a result?

The biggest challenge is greater market uncertainty and execution risk. In the current landscape, aspiring IPO companies need to plan for the possibility of an extended IPO process with an uncertain outcome. This means, for example, being prepared for the challenges of living with a lengthy period of management distraction and quiet period restrictions, and having enough available cash to fund operations in the meantime.

The crisis has put risk management in the spotlight. Stock exchanges already require companies to have a system of internal controls and sound risk management systems. Will the intense focus on managing risk further complicate the IPO process in any way?

Greater attention to risk management—and to the Board of Director's role in providing oversight of the company's risk management—are elements of the heightened standards and expectations that generally apply to all public companies. The particular significance of risk management and risk oversight to IPO planning will depend on the nature of the company's business. For some companies it can complicate the IPO process, while for others it is less of an issue.

New SEC rules (effective February 28, 2010) may require some public companies to discuss how their compensation policies create incentives that affect the company's risk and management of that risk. Apart from these SEC rules, identifying, prioritizing, managing and monitoring risk has long been a prudent part of business planning for every company, whether public or private.

Volatile market conditions have continued to make it difficult for companies to go public. What are the most important factors management should consider as it decides whether an IPO is right for the company?

Management should objectively assess the tradeoffs of going public. An IPO produces cash, liquidity, capital access and enhanced prestige. It can also facilitate employee equity incentives and stock acquisitions. On the other hand, going public requires a significant amount of effort and money, and it results in public company obligations, reduced operating flexibility, less privacy, the diversion of management time from the business, and potential liability.

The company should ask itself questions such as the following: Do we have the revenue, profitability, growth rate and prospective market capitalization for a successful IPO and life as a public company? Is the market likely to be receptive to our business, competitive position, management, financial results and prospects? Can we withstand the diversion of management time demanded by the IPO process? Can we live with the quiet period? As a public company, can our business prosper with reduced privacy, flexibility and control, and can we fully discharge our obligations and responsibilities?

And, under any kind of market conditions, it is very important for the company to have clear visibility on hitting its numbers during the first year or so following the IPO. This is a critical phase when every new public company must crisply execute its business plan and achieve its forecasted earnings in order to maintain credibility, avoid earnings-based volatility in the market price, and minimize the risk of securities litigation.

If management sees an industry peer make a poor debut in the public markets, should it change its IPO preparation strategy? If so, in what ways?

Successful IPOs by industry peers—typically called "comps" by underwriters—is a positive factor in deciding whether to pursue an IPO. The impact of a poor debut by an industry peer depends on the reasons for the poor showing.

If the poor debut reflects general market conditions, then another company in the same industry may need to reconsider its timing or prepare for a less favorable valuation, unless it can clearly distinguish itself from the peer. If the poor debut fundamentally reflects the industry's disfavor among investors, the company may need to reassess its threshold decision to go public. This might cause the company to defer its IPO plans until its business can be improved—perhaps through an acquisition or new product launch—or prompt the company to seek a buyer.

Timing is also relevant: a poor debut by an industry peer shortly before the company prices its own IPO will be much more worrisome than if the company has several months or more to distance itself, both in time and in business or market positioning.

What are the primary roadblocks a company faces as it prepares its initial public offering, and how can it maximize its chances of completing a successful offering?

There are both internal and external roadblocks in IPO preparations. The primary external roadblock is the one over which a company has the least control: market conditions.

The primary internal roadblock to an IPO is the sheer scope and magnitude of IPO preparations—legal, accounting, financial, governance and organizational—and the potential for management distraction at the very time it needs to be laser-focused on running the company's business.

An IPO company will improve its odds of success if:

• the company's management team is experienced and committed to the IPO effort;
• the company begins its preparations long before the formal IPO process begins—typically six to twelve months;
• the company has a sound business model that calls for sustained growth and profitability;
• comparable companies have completed successful IPOs and the company compares favorably with its peers;
• the company can attract managing underwriters with strong track records; and
• the company retains seasoned professional advisors.

David A. Westenberg, a partner in the Corporate Practice Group of WilmerHale in Boston, is author of the acclaimed book *Initial Public Offerings: A Practical Guide to Going Public* (Practising Law Institute, October 2009). Mr. Westenberg has counseled numerous startups from formation through venture financing and on to successful acquisitions or IPOs. As outside corporate counsel to many public and private companies, Mr. Westenberg advises clients on a wide variety of corporate, securities, disclosure and governance matters.

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