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The Board's Role in Deciding Whether to Go Public

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THE BOARD'S ROLE IN DECIDING WHETHER TO GO PUBLIC

Many companies will face the critical decision of whether to go public, and many of the stakeholders in those companies will have little or no experience with the complex process and the factors affecting such a decision.

At Foley's sixth annual National Directors Institute on March 8, 2007 in Chicago, "The Board's Role in Deciding Whether to Go Public," was a featured breakout session moderated by Curt Creely, partner, Foley & Lardner LLP. Distinguished panelists included Daniel Klausner, executive director, UBS Securities LLC; David Peralta, chief operating officer and chief financial officer, NanoBio Corporation; Rod Ruston, president and chief executive officer, North American Energy Partners Inc.; Beth Saunders, founding partner and chairman, Ashton Partners; and Jason Wortendyke, managing director, Midwest Investment Banking, UBS Securities LLC.

The panel focused on company decisions surrounding going public and the role of board members in the process. They discussed a variety of topics, such as 1) choosing professional advisors (bankers, auditors, lawyers), 2) reasons for and against going public, 3) the process of going public and the roles of various participants (board, management, advisors), 4) various costs of being public (street projection expectations, Sarbanes-Oxley compliance), and 5) general media topics (investor relations, gun jumping).

Choosing Professional Advisors

When choosing an investment banker, companies should look for a bank with a strong market presence and one that is well-versed in the company's specific space or sector. "The IPO is the only chance for a company to make a first impression on the public equity markets," commented Jason Wortendyke. A company can of course look at league tables and other sorts of media information to see a bank's IPO prowess and track record, but must be mindful of its fit with the bank. Most companies undertaking an IPO are not the largest corporations and could get lost in the shuffle at a big investment bank; it may be better to find strong middle market players if that is the proper fit. The personal interest the bank shows for the company – taking the necessary time to learn the company's story and build a strong working relationship with management – is also extremely important. Information regarding this can be gleaned from references and demonstrated by a showing of committed resources, such as senior bankers attending meetings and participating in the process. Similarly, a company should look for a bank that will continue to support the company in the aftermarket, after the IPO, including working with the company to develop new solutions and ideas, such as mergers and acquisitions and recapitalizations.

David Peralta commented on the situation of a venture capital investor pushing for an IPO – "if a company waits until the VC pushes for an IPO, it is too late." A company should develop a long-term plan, two to three years prior to the anticipated IPO, which includes an identification and analysis of a group of eight to ten peer companies, from which the company can monitor comparable information, such as what banks, analysts, valuation metrics and liquidity benchmarks that the peer group uses. Also, the company should begin with a group of 10 to 12 banks with whom it is developing relationships and discussing the IPO prospects and a framework for looking at some of the comparable information listed above. Curt Creely commented, “I always tell my clients that going public is an evolutionary process over the course of at least two years, not just the flipping of a light switch shortly before the anticipated date of the offering.” There are also technical considerations in the evolutionary process. Generally, a company should have a demonstrated track record of meeting quarterly budgets and will need to produce three years of audited financials. “People underestimate how difficult it is and how long it takes to get the financials ready for prime time on the schedule required by the public markets,” said Daniel Klausner.

Why Go Public?

Becoming public often gives private owners of the company liquidity, raises needed capital for corporate operations and expansion, and provides currency for acquisitions; however, it is not an easy task either to go public or to maintain a public company. The significant cost of the process sometimes militates against the decision to go public. Mr. Klausner estimates that compliance with the Sarbanes-Oxley Act (SOX) and other SEC and audit-related compliance costs could amount to $2-3 million in additional costs on an annual basis for many middle-market companies.

Case Study: North American Energy Partners, Inc.

Recently having completed a successful IPO, Rod Ruston shared his insights into the process of going public. He stated his firm belief that information dissemination within the company is of critical importance. At the beginning of the IPO activity, North American Energy took employees on a two-day retreat to view presentations by the various professional advisors in the process to explain the steps necessary to become public and also what would be required to maintain a public company. Of course, these professionals will be advising the employees to keep this information within the company.

A primary concern of Mr. Ruston’s was keeping the business running smoothly while dealing with the going public distractions. North American Energy appointed a vice president in charge of IPO matters to coordinate the day-to-day management of the process and keep the others on the board and management informed.

“Banks always like to push timetables,” Mr. Ruston remarked in reference to the fact that timing is always an issue in the IPO process. There is the always-looming problem that financial statements will go “stale,” the SEC does not always work on the timetables that banks like to push, and holidays tend to get in the way.

Earnings Guidance

In turning to the question of earnings guidance, Beth Saunders stated that “it is a myth that unless a company can give quarterly guidance, it should not go public.” There are many factors in the decision of whether, what kind of and when to give guidance. Mr. Klausner agreed, and strongly suggested that companies set guidance expectations on the IPO road show. Companies should look at alternative metrics – “ask yourself what metric you, as the company manager, look at daily that you know lots about and have a lot of history behind, and it’s not necessarily revenue or earnings per share. And you must educate the market about your guidance metric during the IPO process; otherwise, the reeducation process afterward is extremely painful,” stated Ms. Saunders.

Media Issues

Investor Relations. It was suggested that a company does not need the services of an investor relations firm for the entire two to three year process, nor can a good investor relations firm replace good communicators from the company (generally the CEO and CFO) telling the story with clarity and energy on the road show. Specifically, a company should hesitate to put out earnings guidance prior to developing a competent and comprehensive plan for what exactly that guidance should be, and this should be developed with input from all professional advisors. All that said, it was mentioned that an investor relations firm can sometimes serve as a good foil for the company, taking the blame for a bad decision on the part of management, and filtering all the many investor calls that would otherwise be directed to the CEO.

Gun Jumping. "Gun jumping" is a legal term for conditioning the market for the IPO while in registration (the "quiet period"), such as issuing press releases about the IPO or guidance during the IPO. A good rule of thumb, states Ms. Saunders is "if you've never done [the sort of release you are contemplating], the quiet period is not the time to start." In fact, a media spot on the eve of the IPO will be nothing more than a reporting that it is occurring – "you can get more minutes after the IPO is over," she continued. However, if a company can begin developing its story in the media 12 months prior to the IPO, it can turn into something powerful. But as stated above, if the media story includes a guidance metric, it must be well thought out in conjunction with the company's professional advisors, as a change from the developed guidance mid-stream will be difficult to accomplish. Mr. Ruston added that a company "should not hide behind gun jumping" to keep IPO information from employees; "let more people in the management team in the know."

Board Involvement

It is important to keep the board informed at every step of the process, especially when on the road and as the pricing decision comes closer. It is a good idea to have the professional advisors meet with the board at the outset of the process to explain the process and every party's role, so as to avoid getting board members too involved in the nitty-gritty details.

For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.

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Save the date! The 7th Annual National Directors Institute will be held on March 6, 2008 in Chicago. Learn more at Foley.com/ndi.