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IPO and Public Company Readiness: Strategies and Considerations

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Panelists:

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Julia Lapitskaya
Eric Scarazzo
Harrison Tucker

MCLE Information
(60 Minutes Credit)

- Most participants should anticipate receiving their certificate of attendance in 4-6 weeks following the webcast
- Virginia Bar Association members should anticipate receiving their certificate of attendance in 6-8 weeks following the webcast
- **All questions regarding MCLE Information should be directed to CLE@gibsondunn.com**

Today's Panelists

Aaron Briggs is a partner in Gibson Dunn's San Francisco office, where he works in the firm's Securities Regulation and Corporate Governance practice group. Mr. Briggs' practice focuses on advising public companies of all sizes (from pre-IPO to mega-cap), with a focus on technology and life sciences companies, on a wide range of disclosure, compliance, corporate governance, investor communications and ESG matters. Prior to re-joining the firm in 2018, Mr. Briggs served as Executive Counsel – Corporate, Securities & Finance at GE.

Evan D'Amico is a partner in Gibson Dunn's Washington, D.C. office, where his practice focuses primarily on mergers and acquisitions. Mr. D'Amico advises companies, private equity firms, boards of directors and special committees in connection with a wide variety of complex corporate matters, including mergers and acquisitions, asset sales, leveraged buyouts, spin-offs and joint ventures. He also has experience advising issuers, borrowers, underwriters and lenders in connection with financing transactions and public and private offerings of debt and equity securities. Mr. D'Amico has particular expertise in advising special purpose acquisition companies (SPACs), operating companies and investors in connection with SPAC business combinations and financing transactions.

Julia Lapitskaya is a partner in Gibson Dunn's New York office and a member of the firm's Securities Regulation and Corporate Governance practice group. Ms. Lapitskaya advises clients on a wide range of securities and corporate governance matters, with a focus on SEC and listing exchanges' compliance and reporting requirements, corporate governance best practices, annual meeting matters, shareholder activism, board and committee matters, ESG and executive compensation disclosure issues, including as part of initial public offerings and spin-off transactions.

Eric Scarazzo is a partner in Gibson Dunn's New York office. He is a member of the firm's Capital Markets, Securities Regulation and Corporate Governance, Power and Renewables, Global Finance, and Mergers and Acquisitions practice groups. As a key member of the capital markets practice, Mr. Scarazzo is involved in some of the firm's most complicated and high-profile securities transactions. Additionally, he has been a certified public accountant for over 20 years. His deep familiarity with both securities and accounting matters permits Mr. Scarazzo to play an indispensable role supporting practice groups and offices throughout the firm. He provides critical guidance to clients navigating the intersection of legal and accounting matters, principally as they relate to capital markets financings and M&A disclosure obligations.

Harrison Tucker is an associate in Gibson Dunn's Houston office, where he currently practices with the firm's Capital Markets, Mergers and Acquisitions and Securities Regulation and Corporate Governance practice groups. He represents public and private businesses in a broad range of corporate and securities matters. Mr. Tucker represents issuers and investment banking firms in both equity and debt offerings, including Rule 144A offerings. His practice also includes mergers and acquisitions and general corporate concerns, including Exchange Act reporting and corporate governance.

Webcast Agenda

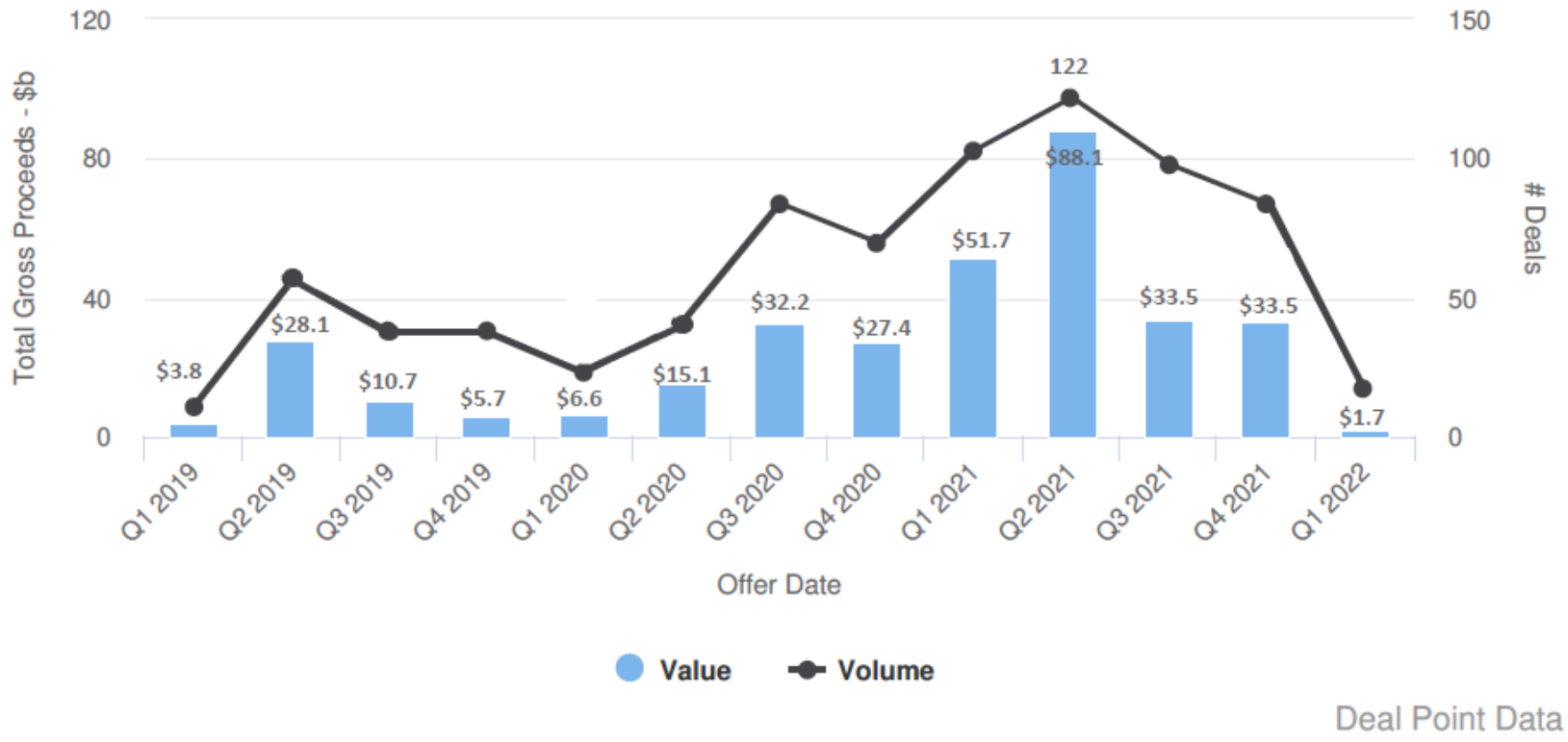
Part One: Considering the Exit Strategies

Part Two: Key Considerations for Pre-IPO Planning

Part Three: Public Company Governance

The Current IPO Market

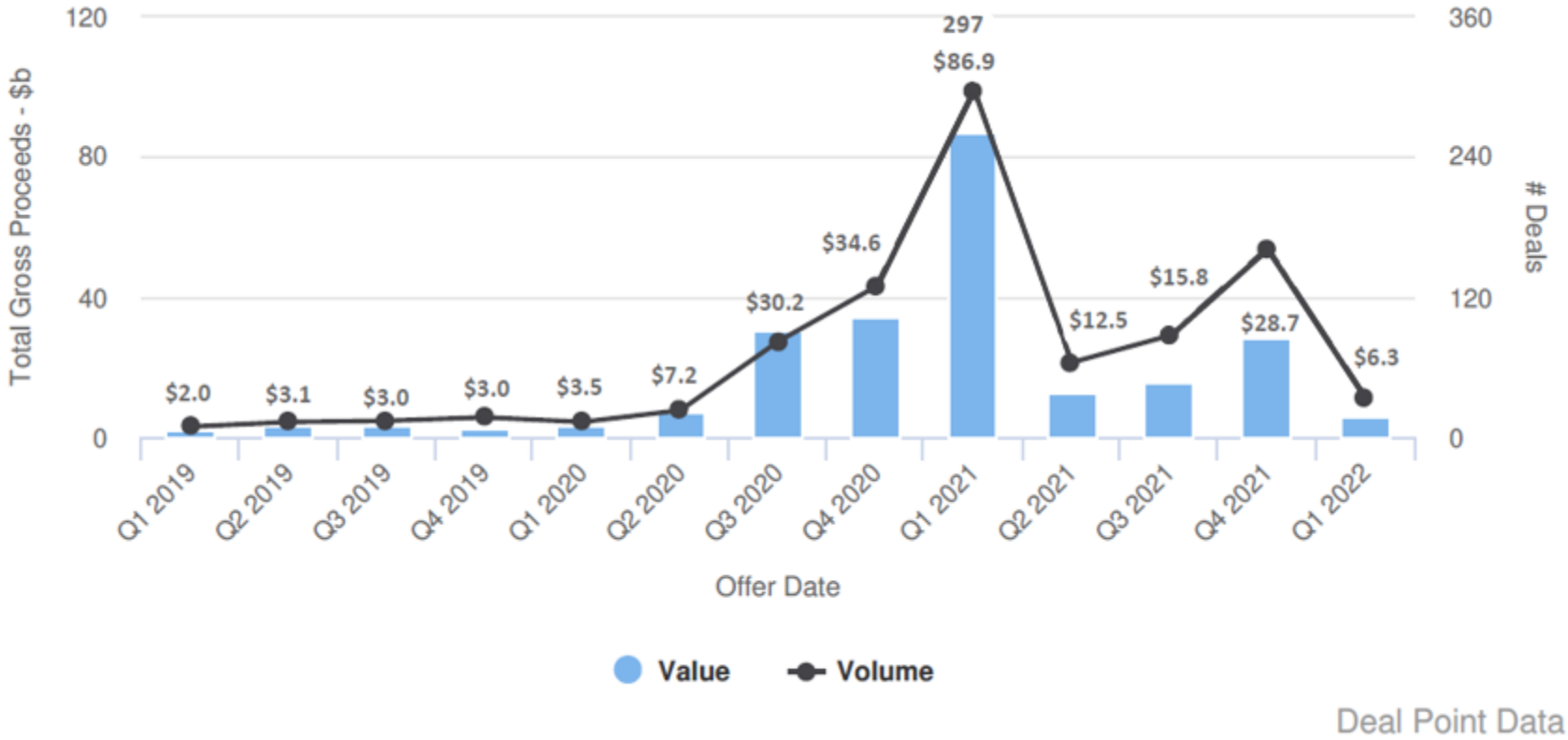
Initial Public Offerings* (Deal Volume & Equity Value)



*Excluding SPAC IPOs

The Current IPO Market

SPAC IPOs (Deal Volume & Equity Value)



Deal Point Data

The Current IPO Market

De-SPAC Transactions (Deal Volume & Equity Value)

Deal Point Data

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Part One:
Considering the Exit Strategies

Considering the Exit Strategies

Traditional Exit Routes from an Investment

- ***Sale of the Company.*** Provides a complete and immediate exit from the investment.
- ***Initial Public Offering.*** A potentially attractive exit strategy used by private equity sponsors, as an IPO can provide the highest returns when optimal market conditions are present.
- ***Secondary Buyout.*** May be an option because it means shortening the life of an investment; complete vs. partial exit strategy varies.

Partial Exits:
Dividends and Recapitalizations

Option to achieve liquidity from investment through a **special dividend**.

The type of dividend is defined by the source the company (or the parent holding company) uses to finance it:

- A **non-leveraged** dividend recapitalization is financed by using cash that the company already has on hand (but likely subject to restrictions in financing documents).
- A **leveraged** dividend recapitalization is financed by the company by incurring additional debt.

The Dual Track Process

A **Dual Track** structure allows the sponsor to preserve optionality as it evaluates the attractiveness of multiple exit (or partial exit) options while hedging against IPO market volatility and overall deal uncertainty.

	Initial Public Offering	Sale Transaction	Dual Track Process
Exit	• Typically a partial exit opportunity (depending on the size of the secondary offering) • Slow sale of securities not sold in the IPO (generally subject to affiliate restrictions under Rule 144 unless a follow-on offering occurs) • Signaling to the market of potential upside	• Generally allows for a complete exit. • Escrow or hold back could cause some funds to be unavailable for a period of time.	• Ability to choose best exit opportunity given the circumstances • Higher negotiating leverage with potential buyers • Generally the costliest option and a distraction to management
Valuation	• Equity valuation determined by underwriters • Charter provisions can give sponsors an effective veto right based on valuation.	• No liquid market for shares, so valuation by company or its advisors is key	• Each process can inform the other.
Future capital raises	• Access to public capital markets for future financing • Once an issuer becomes eligible for S-3 shelf registration and/or a WKSI, easy access to public markets	• Shifted to buyer	

The Dual Track Process

	Initial Public Offering	Sale Transaction	Dual Track Process
Management	• May have greater management support. • Current management will often stay on board post-IPO • Greater visibility and enhanced corporate image • Management retains its equity and is granted new equity	• May be subject to some resistance from management, as strategic buyers may have their own management teams • Financial incentives for management may be great, including future appreciation through rollover	• Higher management distractions due to simultaneous IPO and sale transaction processes • Management may favor IPO due to job security
Legal matters	• Heavy compliance and disclosure obligations • Ongoing Exchange Act reporting requirements • Sarbanes-Oxley compliance	• Subject to antitrust and other anti-competitive review	• Advanced preparation required to address legal concerns of both processes
Cost of transaction	• Expenses are high • Disclosure costs, legal fees, underwriter fees • Ongoing public company costs can add over $2 million per year	• Expenses are high • Risk that competitors may enter bids solely to gain access to confidential information	• Costs can be higher due to running two exit processes in tandem • Overall cost is lower than if one type of exit fails and the other is commenced later
Timing of transaction	• Four to six months from organizational meeting to closing of the transaction	• Typically one to two months	

SPACs – an Alternative to the Traditional IPO

- Special purpose acquisition companies ("SPACs") are public companies that complete a capital raise through an IPO with the goal of using IPO proceeds to complete a business combination. SPACs generally have 18-24 months to complete a business combination to avoid liquidation of the SPAC.

Advantages and Disadvantages of SPAC Acquisition

Advantages

- ❑ Potentially faster timeline than traditional IPO
- ❑ Can facilitate going public during periods of market instability
- ❑ SPAC sponsor may offer operational expertise and investor access
- ❑ Ability to structure transaction in manner not available in IPO or traditional sale, including cash-out of existing owners and earn-outs

Disadvantages

- ❑ Business combination transaction subject to intense SEC review and SPAC shareholder approval
- ❑ Public company readiness necessary for target company
- ❑ Target company's management will need to partner with existing SPAC management and sponsors
- ❑ Due to SPAC's former status as a shell company, post-combination entity subject to SEC requirements that may impact future capital raising and monetization of original investor stakes

Direct Listings – an Alternative to the Traditional IPO

- A direct listing refers to the listing of a privately held company's stock for trading on a national stock exchange (either NYSE or Nasdaq), without conducting an underwritten offering, spin-off or transfer quotation. Similar registration process to a traditional IPO.
- Direct listings involve new risks — ideal for companies with a well-recognized brand or easily understood business model, who can create adequate research coverage / educate investors in the absence of an underwriting syndicate.
- ***Certain Advantages***
  - **Market-Based Price Discovery** — designed to avoid issuer and existing shareholders leaving money on the table as compared to the traditional IPO "pop."
  - **Flexibility in Marketing** — avoid the rigidity of the traditional roadshow, allowing listing company to tailor marketing activities (investor day; webcast; etc.).
  - **Immediate Liquidity for Shareholders** — all eligible shareholders may participate in the first day of trading (as opposed to customary 180-day IPO lock-up).
  - **Wider Participation** — Offers equal access for all investors, not just large institutions and others investors that traditionally have access to IPO shares.
  - **Lower Fees** — Financial advisory fees tend to be lower than traditional underwriting fees.

Direct Listings – an Alternative to the Traditional IPO

Certain issues to consider before choosing a direct listing

- Current rules (approved in 2020 and 2021) allow for primary capital raises in connection with a direct listing (unavailable under the original rules, which allowed only "selling shareholder" direct listings) — must sell $100m in equity during opening auction or meet other standards.
- Investor relations apparatus must be capable of playing an outsized role in coordinating marketing efforts and outreach to potential investors, both in connection with the listing and after the transaction.
- No marketing efforts are permissible without an effective registration statement – marketing requires a gap between effectiveness and first day of trading to establish price range / initial reference price.
- If a company is unable to meet the minimum thresholds ($100m in opening sales / $250m in aggregate market value), the listing is unable to proceed.
- Limited execution history, in particular for primary capital raises.

Considerations for Facilitating a Successful Exit

- ***Governance/Approval Rights***
  - Control is established through the sponsor's ownership and voting rights and Board composition.
- ***Information Access***
  - Requirement to prepare and deliver financial statements.
  - Access to books and records.
- ***Transfer Restrictions***
  - Generally restrict free transferability.
  - Typically accompanied by tag-along rights allowing investors to participate pro rata in sales.
  - If transfers are permitted, they may be subject to rights of first offer or refusal requirements.
- ***Drag-along Rights***
  - Provides greater certainty over sale process.
  - Contractual right to require minority investors to participate in the sale of the portfolio company.

Considerations for Facilitating a Successful Exit

- ***Registration Rights***
  - Power to trigger or participate in registered public offerings of the portfolio company's equity.
  - Consider which holders should be given a right to participate in the IPO.
- ***Redemption Rights***
  - Ability to require the company to repurchase equity under certain circumstances.
  - Pre-wire consequences if the company fails to (or cannot) repurchase equity.
- ***General***
  - Amendment provisions should be carefully considered to ensure flexibility vs. preservation of rights.
  - Consider when various rights lapse.
  - The substance of these provisions vary based on capital structure (control investment, club deal, management rollover).

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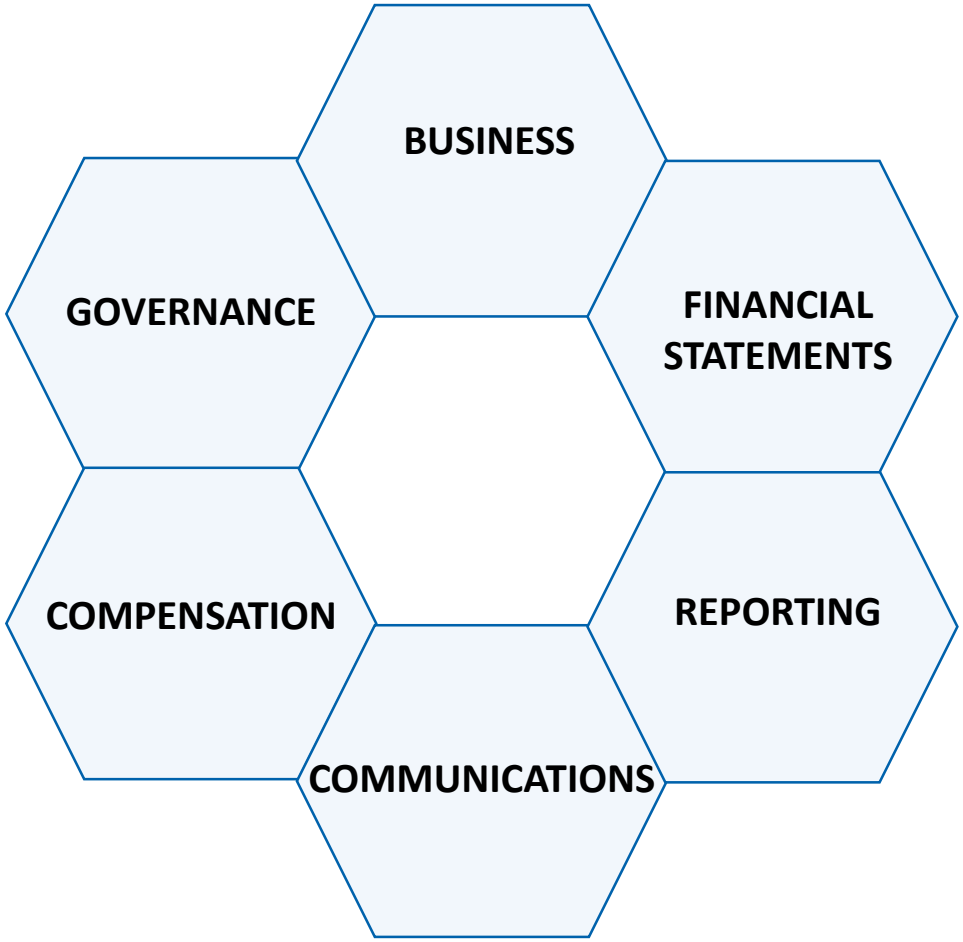
Part Two:
Key Considerations for Pre-IPO Planning

Key Considerations for Pre-IPO Planning

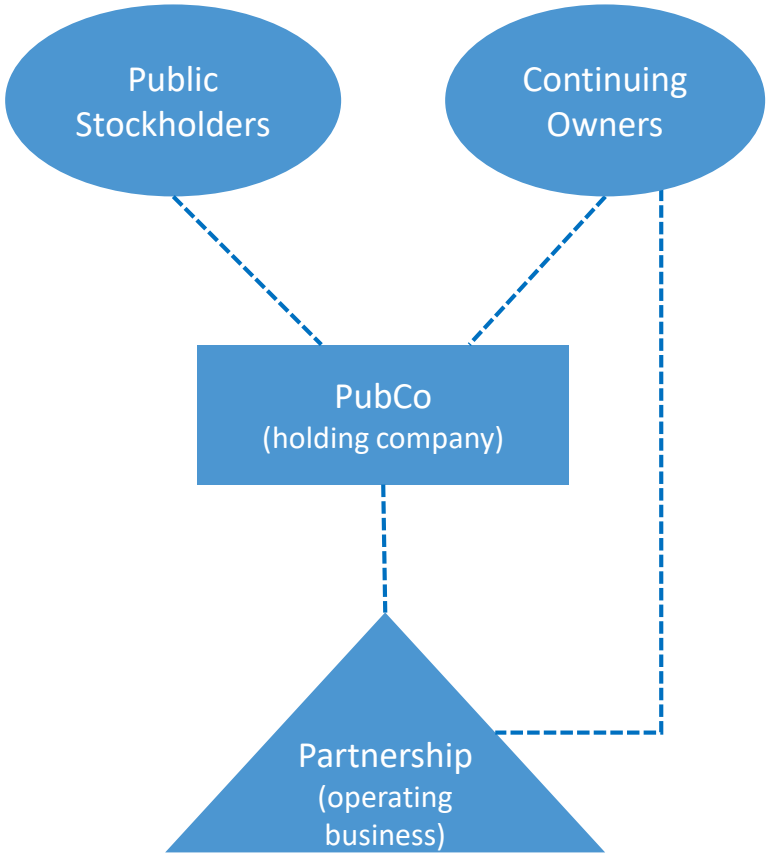


Business Considerations – Structure

The right IPO structure will be influenced by pre-IPO equity structure, tax considerations and current investors' long-term liquidity expectations.

Example: "Up-C" IPO Structure

- A business operating in a tax pass-through form, either as an LLC or a partnership ("Partnership"), can undertake an IPO without converting to a "C" corporation.
- A newly formed corporation ("PubCo") undertakes IPO.
- PubCo then uses IPO proceeds to acquire interests in the Partnership.
- Following the IPO, PubCo will be a holding company, and the Partnership will be its subsidiary.
- The pre-IPO owners will often retain majority ownership of the Partnership and have majority voting control over PubCo immediately following the IPO.



Structure immediately following the "Up-C" IPO

Business Considerations – Pre-IPO Transactions

Examples of Pre-IPO Transactions

- ***Internal Restructuring.*** May be necessary to simplify current corporate structure or set up company for easy transition to desired post-IPO structure.
- ***Acquisitions; Dispositions.*** A material acquisition or disposition prior to or in connection with the IPO may be important to the narrative.
- ***Pre-IPO Financing.*** Provides access to liquidity for growing companies and introductions to investors in anticipation of IPO.
- ***Debt Restructuring.*** Highly leveraged companies may need to restructure their debt prior to or in connection with the IPO in order to bring their leverage to a more acceptable level for public company investors.
- ***Related Party Transactions.*** Companies should take stock of any related party transactions as they may need to be publicly disclosed once the company is public.
- ***Material Contracts.*** A review of material contracts is necessary to ensure no third-party approvals or confidentiality provisions may impact public disclosure.

Financial Statement Considerations

- ***Independence Review of Auditor.*** Independent auditors under stringent PCAOB standards are required. Pre-IPO companies should review the independence of their current auditors well in advance, as independence issues may require a waiver from the SEC or a change in auditors.
- ***Prepare Financial Statements in Compliance with GAAP.*** Public companies will need to prepare audits under the more stringent PCAOB standards, which often requires additional time.
- ***Assess and Document Internal Controls.*** Assessing internal controls early can flag issues well in advance of the IPO process and provide time for the company to prepare and implement effective policies and procedures going forward.
- ***Review Capabilities and Needs of Finance and Accounting Staff.*** Public company reporting places a heavy burden on financing and accounting staff. Additional team members with prior public company experience can help facilitate the preparation of financial statements.

A Note on Public Company Reporting

Jump-Start on Post-IPO Reporting

- **Adopt a periodic reporting schedule.** Financial reporting team, legal and IR should begin preparing quarterly financial information and communications plan prior to IPO.
- **Review comparable company precedent.** Several portions of the registration statement typically require additional time to prepare and will serve as a template for ongoing reporting, including:
  - Management's Discussion & Analysis and Results of Operations
  - Key performance indicators – how industry players analyze performance
  - Risk factors – a discussion of the material factors that could make investing in company's securities risky or speculative

Periodic Report Filing Deadlines	
Annual Report on Form 10-K	Large Accelerated Filer: 60 days after fiscal year end Accelerated Filer: 75 days after fiscal year end Non-Accelerated Filer: 90 days after fiscal year end
Quarterly Report on Form 10-Q	Large Accelerated Filer: 40 days after fiscal year end Accelerated Filer: 40 days after fiscal year end Non-Accelerated Filer: 45 days after fiscal year end

Communication Considerations

External communications are key, and any communications from the company post-IPO will receive closer scrutiny from investors, analysts and regulators.

"Gun-Jumping"

- Securities laws impose strict limitations on communications during the IPO process. Violation of the communication rules (or "gun-jumping") can result in civil liability and significant delay in the IPO.
- Communications during the IPO process generally should be in line with past practice, and references to the IPO or the growth prospects of the company should be avoided.
- Establishing a proper communications system during the pre-IPO planning phase is critical to avoid "gun-jumping" issues and inadvertent disclosure.

A Note on Strengths and Strategies

An important part of the IPO process is crafting the narrative around the company's story, strengths and strategies.

Understanding the story you want to tell to investors and the public early in the IPO process helps set the framework for drafting the registration statement, roadshow and other public materials.

Compensation Considerations

- Equity awards must be granted at fair market value. To support the value of awards in the absence of a liquid market for equity, a third-party stock valuation may be used.
- Pay careful attention to equity grants leading up to the IPO in order to avoid "cheap stock" issues (e.g., grants that are valued below the expected IPO valuation).
- Ensure that any award issuances have been made in compliance with the securities laws governing equity awards.
- Engage external compensation consultant to advise on public company program changes.
- Keep in mind that the IPO registration statement and ongoing public company disclosure will require the company to disclose in great detail the compensation of certain "named executive officers."
- Disclosure in registration statement will include discussion of historical compensation, compensation philosophy, future bonus targets and benchmarks.

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Part Three:
Public Company Governance

Key Areas of Governance Focus in IPOs

- ***Wide Latitude:*** Company generally has wide latitude to determine appropriate governance structure to support execution of long-term strategy, particularly at IPO.
- ***Selected Considerations:***
  - **Flexibility** – preserve board ability to act in shareholders' best interests based on facts & circumstances.
  - **Shareholder base –** decision-making may differ depending on whether or not company is controlled or otherwise has a significant shareholder, founder, etc.
  - **Activist defense** – protect company from inappropriate threats for corporate control.
  - **Market practice** – maintain alignment with peers or have good reason not to.
  - **Delaware law** – shareholder rights, director responsibilities & requirements for board operations.
  - **Listing exchange / SEC rules** – director independence & committee composition / responsibilities and requirements, code of conduct and various disclosure requirements.
  - **Investor / proxy advisor expectations** – view anti-takeover protections as inhibiting shareholder rights; may vote against board members at shareholder meetings based on certain IPO-related governance decisions.
  - **Latest trends** – consider board diversity as well as environmental, social & governance ("ESG") strategies and potential disclosures.

Key Areas of Governance Focus in IPOs (cont.)

- ***Key Areas of Governance Focus in IPOs Include:***
  - "Controlled company" status / exemption
  - Related party / person transactions
  - Anti-takeover provisions:
    - High vote / low vote
    - Frequency of director elections / classified board (with or without sunset)
    - Plurality / majority voting and resignation policy
    - Removal of directors
    - Ability to fill vacancies
    - Stockholder written consent
    - Ability of stockholders to call special meetings
    - Supermajority provisions
    - Statutory freeze provision for tender offers (known as DGCL 203 in Delaware)
    - Blank check preferred & poison pills
    - Exclusive forum provisions
  - Board / committee composition
    - Independence considerations
    - Qualifications / financial expertise
    - Diversity considerations
    - Overboarding considerations
    - Board leadership structure

Additional considerations for sponsor-backed IPOs

- Veto / approval rights
- Board and committee nomination rights
- Observer rights
- Corporate opportunity waivers / conflicts of interest / overlapping director considerations / Clayton Act
- Information and access rights
- Springing DGCL 203 vs. "synthetic" DGCL 203

Key Areas of Governance Focus in IPOs (cont.)

- ***Key Governance Documents / Forms:***
  - Certificate of incorporation
  - Bylaws
  - Indemnification agreement(s)
  - Committee charters
    - Audit, comp & nom/gov
    - Other potential committees (e.g., risk)
  - Corporate governance guidelines
  - Code of Business Conduct and Ethics (including whistleblower provisions)
  - Audit-related policies (RPT policy, auditor personnel hiring policy, pre-approval policy, complaint procedures policy and internal audit charter)
  - Insider trading policy
  - Reg FD policy
  - Disclosure committee charter
  - Clawback policy
  - Stock ownership guidelines for directors and executives
  - Delegation of authority matrix / resolution
  - D&O Questionnaires
  - Other compliance-related polices (e.g., anti-corruption policy)

Considerations:

- Companies should revise or adopt their Board committee charters and corporate policies in advance of an IPO in order to comply with Nasdaq and NYSE listing standards and SEC rules and regulations.
- Corporate policies should be drafted in a manner that both complies with legal requirements but also fits a company's culture and avoids legalese.

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