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Dual Track Process (M&A / IPO) FAQs

As venture-backed companies stay private longer, there are more opportunities for companies to consider a dual track M&A/IPO process. Below we will lay out common questions related to the dual track process, from the M&A perspective, as well as pitfalls to avoid.

1. What is a dual track process?

In our definition, a dual track process is when a high-growth private venture-backed company is preparing for an initial public offering – whether imminently or years away – while simultaneously pursuing a possible M&A exit. A dual track process, therefore, is a way to maximize the potential of a successful exit at the highest possible valuation.

Our perspective is that every late-stage private company should be operating in one of the following two dual track approaches, based on their particular situation and long-term prospects:

- Banker-led active solicitation. In this approach, the company hires an investment banker to guide to identify, solicit and represent the company to possible buyers, while at the same time conducting an IPO. This scenario is described in more detail at Question 4. This approach is generally time limited to run the same time as a normal IPO preparation process, and commences with the formal hiring of an investment banker.
- Holistic approach. In this dual track approach, the company is regularly considering its exit options and building the governance, compliance, legal and financial capacities that will lead to a successful exit. The company is not actively seeking buyers, but open to unsolicited offers from strategic corporate buyers or investors at any point in their lifecycle, including shortly before their IPO. The company and its investors should, however, be actively engaged in evaluating the identity and capacity of potential strategic acquirers so as to be prepared to move efficiently if a compelling offer is received. The company should likewise have cultivated relationships with potential bankers (most of whom are happy to meet with late-stage private companies as a business development exercise) so that it is in a position to rapidly hire a banker to actively solicit M&A offers, should the company's long-term IPO prospects dim or appear less compelling than what may be available in the M&A market. This approach lasts as long as the company remains private.

It is important to note that companies can be and are bought after their IPO. The advantage to being acquired prior to an IPO is that management has more control over the negotiations, and can sometimes drive significantly higher offered valuations by reducing a buyer's risk that their offer will be "topped" by an interloper after the deal is announced. In contrast, if a majority of the stockholders in a public company decides they want the company to be sold, management has significantly less say in the outcome, and buyers may hold back on offering their highest price, so as to save "dry powder" for a public auction of the target company.

Note that customary legal terms – particularly regarding deal certainty and post-closing liability – are significantly more favorable to the selling stockholders in a post-IPO public company target than in a pre-IPO private target; if a target company is on the cusp of an IPO it may have significant leverage to convince a buyer to grant more "public-company-style" deal certainty and liability terms (in particular, by eliminating or greatly reducing indemnification obligations of the selling stockholders).

2. Why should I consider a dual track process as my company matures?

There are several advantages to a dual track process:

- It offers the maximum flexibility for a company looking to keep its options open. The company can switch paths, sometimes even using the potential of an IPO as leverage when dealing with a buyer to drive a higher valuation or better legal terms.
- In a time of market volatility and uncertainty, and when the IPO window can close abruptly, it allows companies to evaluate and choose the best alternative for their business.
- When an IPO is announced it has the potential to entice potential buyers to leave the sidelines and lob in unsolicited bids, which may be advantageous for companies taking the holistic approach and not actively seeking buyers.
- The legal requirements for an IPO, particularly financial data, are complementary to those involved in the M&A process. That makes some aspects of the process, especially with regard to due diligence, more cost-effective.

3. What are the drawbacks to a dual track process? How can I mitigate them?

Every financial transaction has its risks. That's why you hire lawyers. And while there are "rules of the road" and best practices, every dual track process is different and there is no one template. That being said, the best tip is to avoid premature disclosure of IPO or M&A

plans and hence not formally engage an investment banker until youare really ready to kick off your M&A and IPO processes in earnest. While you should feel free to talk to bankers, make sure all of your financial, legal and compliance issues are in order to avoid unnecessary time pressure, especially when it comes to due diligence and board discussions.

Below are several of the most common pitfalls you should be thinking about when consider a dual track approach:

- Management distraction and bandwidth constraints. There is potential for distraction and bandwidth constraints whenever you are considering two complex transactions at once. Particularly in the case of the banker-led approach, both processes are fairly fast and require the attention of the same sets of executives and board members. When the management team is lean, a holistic dual track approach that is open to but not actively seeking buyers may impose fewer stains on management bandwidth – at least until an unsolicited bid materializes.

  After making a realistic assessment of available bandwidth, one way to mitigate the risk is to consider using the same investment banker and legal counsel for both the M&A and IPO processes. That will mitigate the risk of misaligned incentives for the different financial advisor teams and help streamline production of due diligence and other materials, as well as coordinate communications while avoiding errors and leaks.

- Information leaks. Particularly with the banker-led approach, the word gets out that the company is in play. While on the one hand, it makes it easier to solicit potential buyers, the company loses control of the narrative. One way to address this risk is to work with the investment banker to identify target a very narrow number of potential acquirers. The fewer companies that know a company is on the market, the better. However, the risks of a broad outreach, including to financial sponsor acquirers, may be warranted if the company's IPO prospects are constrained and M&A interest among a core group of strategic acquirers is muted. Note however, that financial sponsor acquirers are more likely to have stricter requirements around financial metrics (e.g., recurring cash flows) due to their need to finance the transaction with debt.

- Cost. A dual track process can be costly as you have multiple teams of bankers, accountants, advisers and lawyers involved. Before engaging an investment banker, make sure you have thought through your chain of command structure, who on your legal and finance teams will manage the various workstreams, and how much access you want the bankers and lawyers to have to board members and executives. The more coordinated and streamlined the process is, the more cost-effective it will be.

- Changing legal counsel. It is somewhat common for a company to choose legal counsel for their IPO that, unknown at the start of the process, is regular M&A counsel for a would-be buyer. In that situation, if the company is interested in pursuing the M&A transaction, they need to change legal counsel to a firm that does not already have a conflict of interest. That can lead to lost time and increased expense, including the loss of many of the synergies in IPO disclosure work and M&A diligence production that legal counsel would otherwise be able to leverage.

  Gunderson Dettmer made a commitment from inception to not represent serial acquirers like Amazon, Walmart, eBay, Google, Cisco, Facebook, PayPal and others, and compared to many of our peer firms it is rare for us to need to decline a sell-side M&A transaction due to a prior relationship with the buyer. That protects our clients from the unnecessary cost of changing counsel.

4. How early in the IPO prep process should I be thinking about pursuing a dual track approach?

As noted in Question 1, if a company pursues the holistic dual track approach, management and the board should be thinking about M&A exit potential early on in their long-term IPO preparations. In addition to growth and the day-to-day strength of the business, they should be focusing on any issues that may impact the company's valuation or slow down an M&A transaction.

The company should pay special attention to diligence matters through the perspective of a would-be buyer, as well as regulatory compliance, governance issues, commercial disputes, data privacy issues like GDPR/CCPA, and intellectual property ownership issues. They should engage in penetration testing to identify any weaknesses in data security. They should invest in a good contract management system. Companies should also be careful to avoid giving third parties, such as commercial and financing sources, consent rights that allow them to veto the transaction or terminate their contracts in a change of control. By engaging in these best practices, the company can avoid a painful pivot if an otherwise attractive unsolicited offer materializes at any stage of the IPO process, including on the eve of the IPO.

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If you have any questions regarding the dual track process, or the M&A process in general, please do not hesitate to reach out to one of our M&A team leaders:

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