



NEW YORK STOCK EXCHANGE™

THE ENTREPRENEUR'S ROADMAP FROM CONCEPT TO IPO

www.nyse.com/entrepreneur



**Download the electronic version
of the guide at:
www.nyse.com/entrepreneur**

INTRODUCTION TO IPO READINESS

Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP

Richard C. Blake, Corporate Partner

Heidi Mayon, Corporate Partner

As an entrepreneurial company's growth begins to gain scale and accelerate, a natural question is, What's next? Of the typical answers—continue to grow as a private company, be acquired, or conduct an initial public offering (IPO)—the IPO is the one path that eventually requires a company to fundamentally change its stockholder base, governance structure, internal and external reporting, and compliance framework. These changes take time, and at some point in an entrepreneurial company's lifecycle it should begin to consider IPO readiness, even if staying private or selling the company remain viable possibilities.

This introduction to the IPO readiness process outlines what companies should think about and address beginning several years before the IPO organizational meeting—the official “kickoff” for an IPO—to prepare for that transition.

BEGIN WITH THE END IN MIND, AND BEGIN AS EARLY AS IT MAKES SENSE

The companies that most successfully transition to public companies realize from the beginning that the IPO is not an event unto itself but just one step along a maturing company's lifecycle. Both before and after the IPO, the company has corporate strategies and objectives that transcend the IPO. Companies must simultaneously execute their business and begin to put in place the people, processes and systems that will allow them to successfully conduct an IPO and grow as a public company.

It would be too trite, and not entirely accurate, to say that it is never too early to start preparing for an IPO. Many companies, however, start too late and are forced to “catch up” after making definitive IPO plans. Deciding when to start IPO planning is very company specific, but in most cases, beginning some activities two to three years before an IPO organizational meeting is appropriate.

THE FUNDAMENTAL PRINCIPLE OF IPO READINESS: BEGIN TO RUN YOUR COMPANY IN KEY WAYS AS IF IT WERE ALREADY A PUBLIC COMPANY

The companies that most successfully transition to life as a public company are the ones that start acting like a public company by the time of the IPO organizational meeting in certain key ways, particularly:

- Setting, achieving, and reporting quarterly and annual financial targets
- Building a finance, accounting, and legal team that is capable of meeting the timelines and substance of public company periodic reporting with the Securities and Exchange Commission (SEC)
- Recruiting a public company quality management team and board of directors

If companies can successfully transition to public company readiness in these areas before an IPO, they can avoid any embarrassment and stock price drop from stumbling early on as a public company. Further, public statements from the SEC clarify that it expects private companies—particularly ones aspiring for an IPO—to improve their transparency with investors, controls on financial reporting, and corporate governance, even as private companies.

BEGIN TO ASSEMBLE THE TEAM

It will take a small army of internal and external advisors to work on a company's IPO. In the early days of IPO preparation, when the company is still several years away from an IPO, an internal working group of key employees from executive management, finance, and legal typically lead the process, particularly the chief financial officer, controller, general counsel, and others from the legal team. The external group of advisors is also usually smaller at this point, consisting primarily of:

- External legal counsel, who can advise on the IPO process and IPO readiness generally, and on SEC reporting requirements, corporate

governance, and stock exchange listing standards, due diligence, and other legal matters specifically

- Independent auditors, who will audit your historical financial statements and ensure that they meet SEC reporting requirements as well as advise on the company's internal control environment and on readiness of the finance team to meet SEC reporting requirements
- Consulting accountants, who can assist the company in finance and accounting tasks that the independent auditors are unable to perform because of SEC auditor independence rules. These include accounting advisory services, assisting to draft historical financial statements, designing and implementing enhanced accounting controls and systems, and supplementing the company's internal finance and accounting team until the company has internally hired all necessary staff to function as a public company

While there is no legal impediment to switching advisors on a company's path to an IPO, the process of doing so is distracting and time consuming and is best avoided by selecting the right advisors at the outset. Each advisor should have experience successfully guiding companies through the IPO process and advising public companies after the IPO.

The companies that most successfully execute IPO preparation have "regular" meetings of the internal and external working group. These meetings are a time for internal education about the IPO process and public company readiness, as well as a time to assign and report on IPO readiness tasks. In the years before an IPO organizational meeting is held, the meetings may be held less frequently; in the year before the organization meeting, the meetings are typically held more frequently—eventually weekly—to ensure that everyone is staying on track with assignments.

The company's underwriter selection is also key for its IPO. A company will want to select underwriters with a strong reputation in the

investment community. In addition to reputation, companies should consider:

- *Expertise and experience:* Choosing an investment bank with a track record of executing IPOs for similarly situated companies is essential. A company will also want to select an investment bank with expertise in that company's particular industry and sector. Those investment banks will have good relationships with long-term investors interested in that industry, will be able to introduce the company to those investors in pre-IPO "testing the waters" meetings, and will have greater success in placing the company's IPO shares in the hands of those investors.
- *Individual bankers:* The individual bankers working on the IPO will be key in drafting the company's story that will form the basis of the investment thesis for new investors. Bankers with expertise and experience in a particular industry will be able to anticipate the questions new investors may have with respect to a company's story, answer those questions preemptively, and drive the new investment community's understanding of the company in the proper direction.
- *Research analysts:* A company should also pick an investment bank that has a research analyst who clearly understands the company and the industry in which it operates. While underwriters are not able to promise specific analyst coverage following an IPO, most research analysts at investment banks that served as underwriters begin covering the company. Good research analyst coverage is a requirement to support a stock in the public market.

Discussions with potential underwriters should begin a year or more prior to the organizational meeting. A company will want time to develop a relationship with the individual bankers and understand the capabilities of a particular bank as well as the research analyst. The final decision on which bank to actually engage for the IPO may be delayed until approximately a month prior to the actual organizational meeting.

Other advisors who begin assisting in IPO preparation in the year before an IPO include:

- Compensation consultant
- IPO consultant
- Investor relations consultant
- Financial printer and electronic data room provider

During the IPO, additional IPO and post-IPO advisors join the team:

- Roadshow coach
- Transfer agent
- Stock option administrator
- Electronic roadshow provider

GET YOUR FINANCIAL HOUSE IN ORDER

One tremendous change between being a private company and being a public company is financial reporting, both historical as well as forward looking. Getting your financial house in order can take several years before the IPO organizational meeting, so understanding the financial statement requirements in an IPO and what is expected of public company finance teams after an IPO is a key area of IPO preparation.

In the registration statement that is filed in connection with an IPO, the company will need to include:

- Audited financial statements for the three most recently completed fiscal years or the two most recently completed fiscal years if the company is an emerging growth company under the JOBS Act of 2012 (i.e., one with less than \$1 billion in annual revenue), as most entrepreneurial companies are
- Unaudited interim financial statements for the most recently completed three-, six-, or nine-month interim period and the corresponding period of the preceding year
- Management's discussion and analysis (MD&A) of the audited and unaudited interim financial

statements included in the registration statement

- Selected financial information for up to the five most recently completed fiscal years
- Selected quarterly financial data for up to the eight most recently completed fiscal quarters
- Key financial and operational metrics, if any, that the company uses to analyze and manage its business decisions
- Separate audited and interim financial statements and pro forma financial information of certain significant acquisitions
- Other financial information, such as segment reporting and financial statements schedules, depending on the company's circumstances

After an IPO, the company must file a quarterly report with the SEC within 40 to 45 days of the end of the fiscal quarter, including the unaudited interim financial statements and the related MD&A. Within 60 to 90 days of the end of the fiscal year the company will be required to file an annual report with the SEC with audited financial statements.

As a private company, the company may have worked with its independent auditors to complete audits of past annual fiscal periods, but those audits likely were not completed in accordance with SEC requirements for public companies or within the time periods required for annual reports due after an IPO. In addition, private companies typically do not “close the books” each quarter or prepare interim financial statements, nor do they design, document, and test their internal controls at the level required by Section 404 of the Sarbanes-Oxley Act of 2002.

As a result, a major component of a company's IPO preparation involves:

- Identifying and preparing the annual and interim financial statements that would be required in an IPO registration statement
- Building the internal financial reporting staff necessary to prepare these financial statements, as well as closing the company's books each quarter and preparing the

quarterly and annual reports to be filed with the SEC

- Beginning the process of designing, documenting, and testing the company's internal control over financial reporting

The other key area of financial IPO preparation is building a financial planning and analysis (FP&A) team that can prepare forward-looking financial models, identify key performance indicators (KPIs) the company will use to analyze and manage its business, and work with the financial reporting team to report the company's quarterly and annual results. During the course of its IPO, a company will begin to share its projections and model with the research analysts at the investment banks that make up the underwriting syndicate. This model will serve as the preliminary basis in determining the company's IPO price range and gives the research analysts a starting point from which to build their own models that will become the basis for their research reports on the company following the IPO. The company's ability to set and achieve attainable quarterly and annual financial targets is crucial to a newly public company's credibility with these research analysts and public investors.

The companies that most successfully transition to life as a public company are the ones that start the FP&A process early and test the company's ability to forecast, project, and achieve its quarterly and annual KPI targets while the company is still private and not subject to the scrutiny of public analysts and investors. Many companies go so far as to “issue quarterly guidance” to its board or audit committee and then prepare a quarterly earnings press release and hold a mock quarterly earnings call with its board or audit committee and its external advisors to prepare to be in the public spotlight.

BOARD, MANAGEMENT, AND GOVERNANCE

BOARD RECRUITMENT AND COMPOSITION

According to “By the Numbers: Venture-backed IPOs in 2016,” a Gunderson Dettmer survey

of key corporate governance and disclosure topics in IPOs (IPO Survey), at IPO closing boards of emerging growth companies usually range from five to nine persons and average approximately seven persons. Both the New York Stock Exchange and the Nasdaq listing rules require that within 12 months of an IPO closing, a majority of a listed company's board be "independent directors." The IPO Survey, however, found that 94 percent of venture-backed IPO companies in 2016 had a majority of independent directors at the time of IPO closing.

In addition, both stock exchanges require listed companies to have adopted audit, compensation, and nominating committees by the time of the IPO. The audit and compensation committee members must meet heightened independence requirements from the standards applicable to the board in general. In addition, an audit committee must have at least one "audit committee financial expert." There are phase-in periods for meeting the required committee independence tests:

- One committee member must be independent at IPO closing.
- A majority of committee members must be independent within 90 days of IPO closing.
- 100 percent of committee members must be independent within 12 months of IPO closing.

The IPO Survey found, however, that nearly all venture-backed IPO companies in 2016 had entirely independent board committees at the time of IPO closing, as well as at least one audit committee financial expert.

Ideally, the process of on-boarding additional directors takes place over time, one by one, to minimize disruption to the board. Companies should begin early to analyze the knowledge, backgrounds, and skills sets—as well as personalities—that will be needed on the board to effectively execute a company's business strategy as well as operate as a public company.

In the process of assembling its post-IPO board, we recommend that companies prioritize

recruiting an audit committee financial expert who has certain specialized experience and training that enable a deep understanding of financial results and accounting. There is a high demand for such persons, and identifying one who also has the right personality and professional experience to contribute to the board can be time consuming.

Venture-backed companies going public also need to shift from a VC-investor-centric board to one with more operational, accounting, and industry expertise. A few key considerations when evaluating the composition of a future public company board are:

- The number of directors with experience operating or advising a public company
- The specific regulatory and financial expertise of directors
- Industry expertise of directors that enables issue spotting and unique viewpoints
- Directors that are focused on governing for the benefit of all of a company's investors

MANAGEMENT TEAM

A company should begin evaluating the capabilities of its management team more than a year prior to the time of its IPO, asking whether each has the expertise and ability to scale into a public company executive, and whether additional personnel should be recruited. Often, a company will need to bring on a CFO who has experience reporting financial information of a public company and communicating those results to public investors. A general counsel, COO, and additional finance and sales personnel are also often added in the year leading up to an IPO.

CORPORATE GOVERNANCE

By the time a company goes public, it will be required to adopt a number of new "public company" policies and procedures to comply with SEC and stock exchange listing standards. Many companies, particularly those with a larger number of employees or broader geographical scale, begin this process in the year or so

before the IPO by adopting several key policies, including:

- Code of business conduct, which sets the company's expectations regarding honest and ethical conduct, including handling conflicts of interest; compliance with applicable laws, rules, and regulations; prompt internal reporting of violations to an appropriate person; and accountability for adherence to the code
- Compliance policy and hotline, which gives employees a means by which to make confidential and anonymous reports regarding concerns
- Public communications policy, which addresses who may act as a company spokesperson and what type of information the company may disclose publicly, which may include policies regarding use of social media

LEGAL PREPARATION

Ideally the company has been working closely with external counsel since it was incorporated to make sure it has complied with legal formalities. No later than the year before a company goes public, however, it should begin working with its external counsel to make sure it is prepared on two main legal fronts for its IPO, due diligence and registration statement drafting. Ideally, the company can walk into the IPO organizational meeting with its due diligence data completely prepared and a draft of the registration statement ready.

Following the IPO organizational meeting, the underwriters and their counsel will want to ensure that the company's historical legal and other documents have been reviewed and that information included in the registration statement has sufficient factual support. In advance of the organizational meeting, the company, working with external counsel, typically prepares a "virtual data room" containing electronic copies of these documents, which can take some time to compile and upload. In advance of creating a data room, the company and external counsel typically review the company's records to ensure whether any corporate housekeeping should be

done in advance of the IPO. Most importantly, this housekeeping review would include the following:

- Reports on past board, committee, and stockholder actions to ensure they are complete and accurate
- Historical issuances of stock and options to ensure that they comply with state and federal corporate and securities requirements and that the company's capitalization records are accurate and complete
- Organizational documents and material agreements to understand which may be required to be filed with the SEC in connection with the IPO, what approvals are necessary for the IPO, whether the IPO triggers any rights or responsibilities for the company, and whether anything else limits the company's business in any way
- Intellectual property protection and status

External counsel can also assist the company to prepare the registration statement that will be required to be filed with the SEC. Some of the sections of the registration statement—including the section describing the company's business and MD&A—are typically drafted in collaboration with the entire IPO working group and take a great deal of time after the IPO organizational meeting. External counsel, however, usually assists in drafting the remainder of the registration statement before the organizational meeting, including the risk factors, description of management and the board, executive compensation, principal stockholders, related party transactions, and description of capital stock.

FINAL PRACTICAL ADVICE

It is easy to become overwhelmed at the amount of work that an IPO will take. Entrepreneurs who begin IPO planning early, start running their company like a public company in advance of the organizational meeting, and address the key lead-time items discussed above will put their companies in a better position to successfully execute their IPOs and continue to grow as a public company.



**Gunderson Dettmer Stough
Villeneuve Franklin &
Hachigian, LLP**

1200 Seaport Boulevard
Redwood City, California 94063

Tel: +1 650 321 2400

Web: www.gunder.com

RICHARD C. BLAKE

Corporate Partner

Email: rblake@gunder.com

Richard C. Blake leads the Public Offerings, Public Company Representation, and Corporate Governance practice group at Gunderson Dettmer, LLP. Richard has vast experience preparing companies for public offerings, as well as counseling companies and boards of directors on complex public company matters. Richard has led public offerings for companies across a broad range of industries, including enterprise software, Internet, media, ad-tech, retail, life sciences, telecommunications, semiconductors, entertainment, energy and clean technology, and automobiles. He assisted as counsel to the NYSE's Commission on Corporate Governance and is a frequent speaker at conferences for the Society of Corporate Governance, NIRI, PLI, and NYSE Euronext. Richard is coauthor of "By the Numbers: Venture-backed IPOs in 2015."

He has clerked for judges on the United States Court of Appeals for the Ninth Circuit, and the Utah Supreme Court. He holds a BA with honors and a JD with honors from Brigham Young University.

HEIDI MAYON

Corporate Partner

Email: hmayon@gunder.com

Heidi Mayon is a partner in the Public Offerings, Public Company Representation, and Corporate Governance practices at Gunderson Dettmer. Heidi has represented corporations, investment banks, and investors in more than 100 initial public offerings, follow-on offerings, confidentially marketed offerings, and PIPE transactions. She regularly advises late-stage private companies on a wide variety of topics relevant to the IPO process. Heidi serves on the Capital Markets Advisory Committee of Law360, is a member of the California Corporations Commission, and is a frequent speaker on topics relating to capital markets transactions. She is coauthor of several chapters discussing the IPO process in the widely used treatise *Venture Capital and Public Offering Negotiation* and is a coauthor of "By the Numbers: Venture-backed IPOs in 2015." Heidi holds a BA from the University of San Diego and a JD from the University of San Francisco and is licensed to practice in California.