

IPO Boom Offers Opportunities For Small Companies

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There has been a recent surge in initial public offering activity in early 2017, with more than 20 IPOs through the end of the first quarter of 2017 accounting for nearly \$10 billion of value. On the heels of the recent successful completion of an IPO by a popular tech company, a handful of smaller companies have followed suit, and a large number seem to be lining up right behind them.[1] The smaller companies are now hopping aboard the IPO boom.

But why go public today when companies seem to get funded by, and most of the money and deals are focused on, the private equity markets? The recent IPO rush may be more of an anomaly for the large “unicorns” than a trend to watch for the future, but there appears to be a window for smaller companies looking to go public. While yes, there will still be other IPOs of larger magnitude for unicorns, there will not likely be a run on these. As discussed at a meeting of the Investor Advisory Committee of the [U.S. Securities and Exchange Commission](#), the current investor mentality, as well as other factors, has caused the IPO drought of the past few years.[2]

Historically, voting rights have been highly valued. However, today’s investors appear to be much more concerned with their return on investment, profit and their bottom line. As the committee discussed, investors in the stock market have become so driven by the profit of a company’s stock, the long-term vision of the investment has become lost. Consequently, investors have become less interested in the other virtues of stock ownership (voting rights, for example) and fixated on the fast-money-making potential of securities trading. One result of this demanding market is that companies have chosen to stay private, as opposed to going public, therefore causing a large decrease in IPOs generally.

During a recent SEC Advisory Committee on Small and Emerging Companies roundtable discussion,[3] regarding the topic of secondary market liquidity for Regulation A companies and reporting companies not listed on an exchange, the committee discussed the trend of companies staying private. While the Investor Advisory Committee discussed the market pressures that are keeping companies private, this discussion focused on the potential advantages for companies in staying private. One major reason was that private companies do not have as much regulatory burden as public companies do. Disclosure requirements of public companies can be time-consuming and, more importantly, expensive. Therefore, because of the combination of market pressures from largely impatient investors, and the realities of going public, companies have found a much larger upside in staying private, or at least waiting much longer before going public.[4]

Notwithstanding these developments, there have been numerous recent advances that offer alternatives to the traditional IPO for smaller and emerging companies that wish to raise capital. The advent of the Jumpstart Our Business Startups Act has helped make a difference and has led to a re-emergence of the IPO market. Specifically, the Jobs Act has made it possible for emerging growth companies (companies with total annual gross revenues of less than \$1 billion during its most recently completed fiscal year), to go public using scaled disclosure, enabling

these companies to explore the possibility of an IPO in ways not before permitted, using the “test the waters” provision.

Further, the Jobs Act also unveiled the newly formatted Regulation A-plus, as well as Regulation Crowdfunding, both of which have created interesting and useful tools for companies (both small and large) that are contemplating a capital raise, allowing them to get a sense of potential investor interest in the early stages of their possible offering, and even allowing for the use of general solicitation in connection with offerings. This has led to the exploration and use of new social media tools by companies seeking to raise capital and go public. However, at this point in time, we believe Regulation A-Plus is still an unproven and underused alternative to raising capital. In the wake of the Elio Motors raise,[5] companies have yet to find notable success using this option due to logistical issues surrounding depositing of shares, as well as tradability and Depository Trust Co. eligibility, among other issues. While we firmly believe that Regulation A-Plus will be a valuable tool to raise capital in the future, which will be driven by the way millennials are increasingly looking to do business, it is not quite ready for prime time yet.

In the 1990s, IPOs were common, with over 500 completed per year between 1993 and 2000 on average. At the end of 1999, there were more than 10,000 publicly traded companies. After the tech bubble burst, between 2000 and 2013, there were on average only 150 IPOs completed per year. Today, there are less than 3,500 U.S.-based [Nasdaq](#) and New York Stock Exchange ([Amex](#)) listed companies.[6] In contrast, there are more than 30,000 portfolio companies held by U.S.-based venture capital and private equity firms.[7]

Since the adoption of the Jobs Act, there has generally been an upward trend in the number of IPOs completed, with more than 200 companies completing an IPO in 2014. While there was a setback in 2016 with 111 IPOs due to economic and geopolitical forces, there has been a recent surge in early 2017 with more than 20 IPOs as of March 31, 2017.[8] Additionally, between June 2015 and February 2017, there have been 210 Regulation A filings, with a little more than half of which are Tier II filings. While Regulation A has not become mainstream yet, it seems to have attracted issuers that are either in the real estate sector or issuers that have what some people refer to as an “affinity group” or loyal brand followers who are interested not only in investing but also in owning the product or brand. Moreover, from May 2016 to May 2017, there were approximately 170 Regulation CF filings offerings of which were made via a little over 20 different funding portals. While this may seem like a good amount, the issue with Regulation CF is the \$1 million cap on the amount that can be raised under this provision.

For companies looking to raise capital and considering going public, management teams must understand that when they present themselves to bankers and investors, they sometimes only get one good shot and that first impressions do matter. This means that they need to be clear and specific in their message, be well-organized in their presentation, and show that they are committed to doing what it takes to get the offering done in an efficient manner. Often, the distinction of companies that successfully get their deals done is the fact that they created momentum by being on top of things from the get go and staying on top of things throughout the process.

So what do companies that are thinking about going public need to consider and be prepared for?

1. Understand why they are undertaking the proposed offering, what they expect to get out of it, and the costs, benefits, risks and timing involved in an IPO;
2. Have their financial statements audited in accordance with [Public Company Accounting Oversight Board](#) standards;
3. Prepare a complete disclosure document that details the business, risks, material contracts, management personnel and shareholdings of the company;
4. Be prepared to have an SEC-compliant website and disclosure policy;
5. Understand the need for a commitment to shareholder communications; and
6. Hire and work with experienced and competent professionals — investment bankers, attorneys, accountants, investor and shareholder relations firms, and other service providers, such as website hosting and/or management firms, transfer agents and SEC EDGAR filers.

In going public, management teams continue to seek the ability to maintain control over their companies. This can be accomplished in various ways, including through the offering of nonvoting shares to investors or the issuance of supervoting majority shares to founders or management of a company. For example, [Google](#) has continued to be controlled by their founders, Larry Page and Sergey Brin, through the Class B common stock that they own, while the publicly listed shares consist of Class A voting common stock and Class C nonvoting common stock. This type of capitalization structure is not unique by any means to the unicorn or big companies of the capital markets. It has been used for many years by small and emerging companies as well, whether in the form of classes of common stock, preferred stock or a combination of the two, and will depend, in great part, upon the company and management team involved, the company's operating history and future prospects, and investor demands.

Companies should carefully consider all of their options before committing to the traditional IPO. Many companies may be better suited using the various other options at their disposal. Companies of all sizes are poised to raise capital, but it is crucial to select the best route in order to fully take advantage of the current state of the market.

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- [1] http://www.bizjournals.com/sanjose/news/2017/03/24/here-s-why-ipo-hopefuls-shouldn-t-wait-much-longer.html?ana=yahoo;%20http://www.investors.com/news/technology/alteryx-ipo-pops-23-adding-fuel-to-market-for-initial-public-offerings/?src=A00220A;%20http://www.marketwatch.com/story/next-wave-of-tech-ipos-looks-nothing-like-snap-2017-03-23?siteid=yhoof2;%20https://www.linkedin.com/pulse/nyc-ipo-outlook-poised-strong-growth-derek-steinhiser?trk=v-feed&lipi=urn%3Ali%3Apage%3Ad_flagship3_feed%3BDUZbsCfslnJKk2MbnW6H6A%3D%3D
- [2] <https://www.sec.gov/spotlight/investor-advisory-committee-2012/berger-remarks-iac-030917.pdf>
- [3] <https://www.sec.gov/spotlight/advisory-committee-on-small-and-emerging-companies.shtml>
- [4] <https://www.sec.gov/info/smallbus/acsec/giovannetti-presentation-acsec-021517.pdf>
- [5] <https://www.crowdfundinsider.com/2016/02/81236-elio-motors-closes-at-17-million-touts-50000-reservations/>
- [6] http://www.nasdaq.com/reference/market_facts.stm
- [7] <https://www.pitchbook.com/>
- [8] <http://www.dealogic.com/insights/>