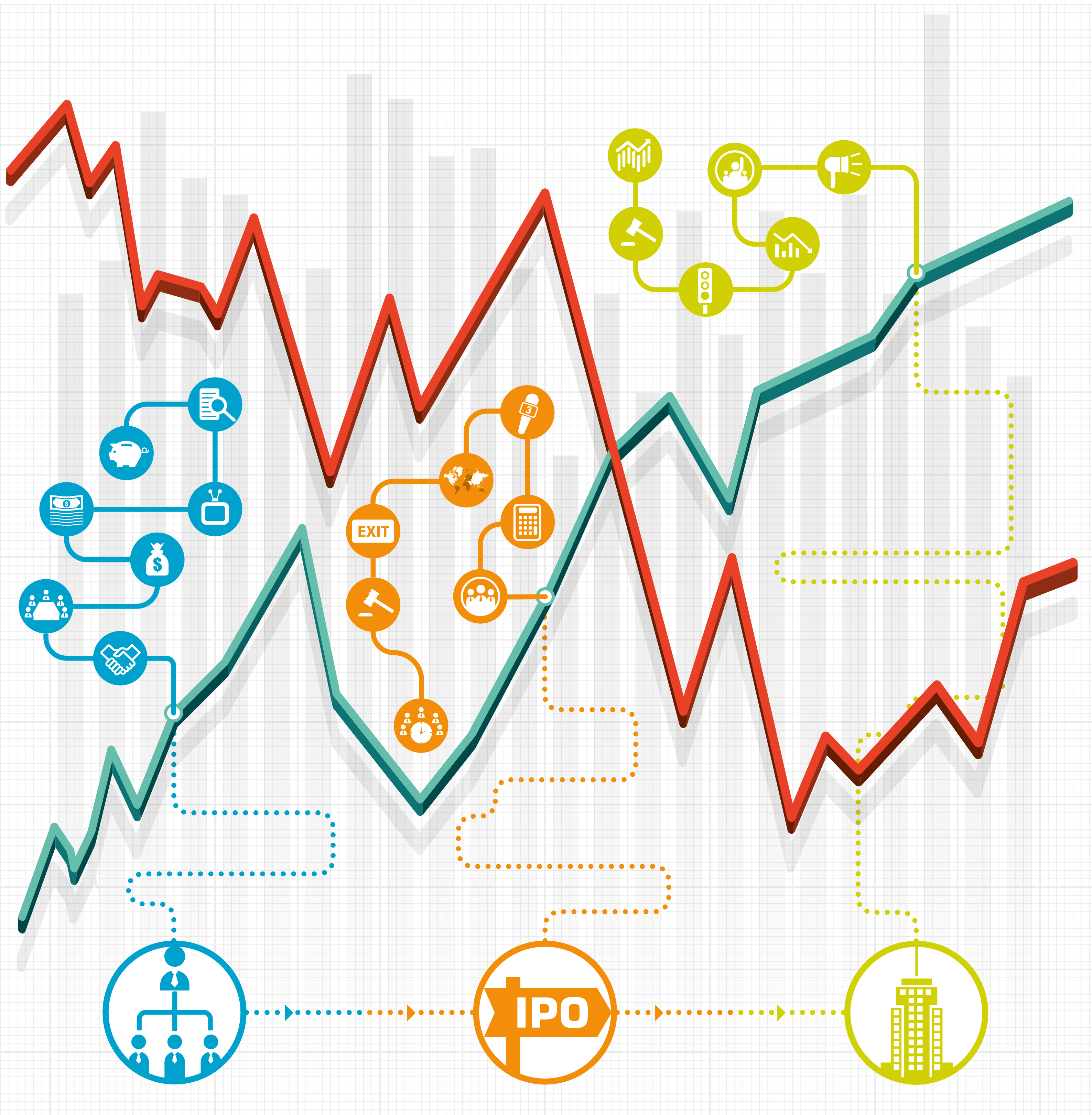
Reed Smith

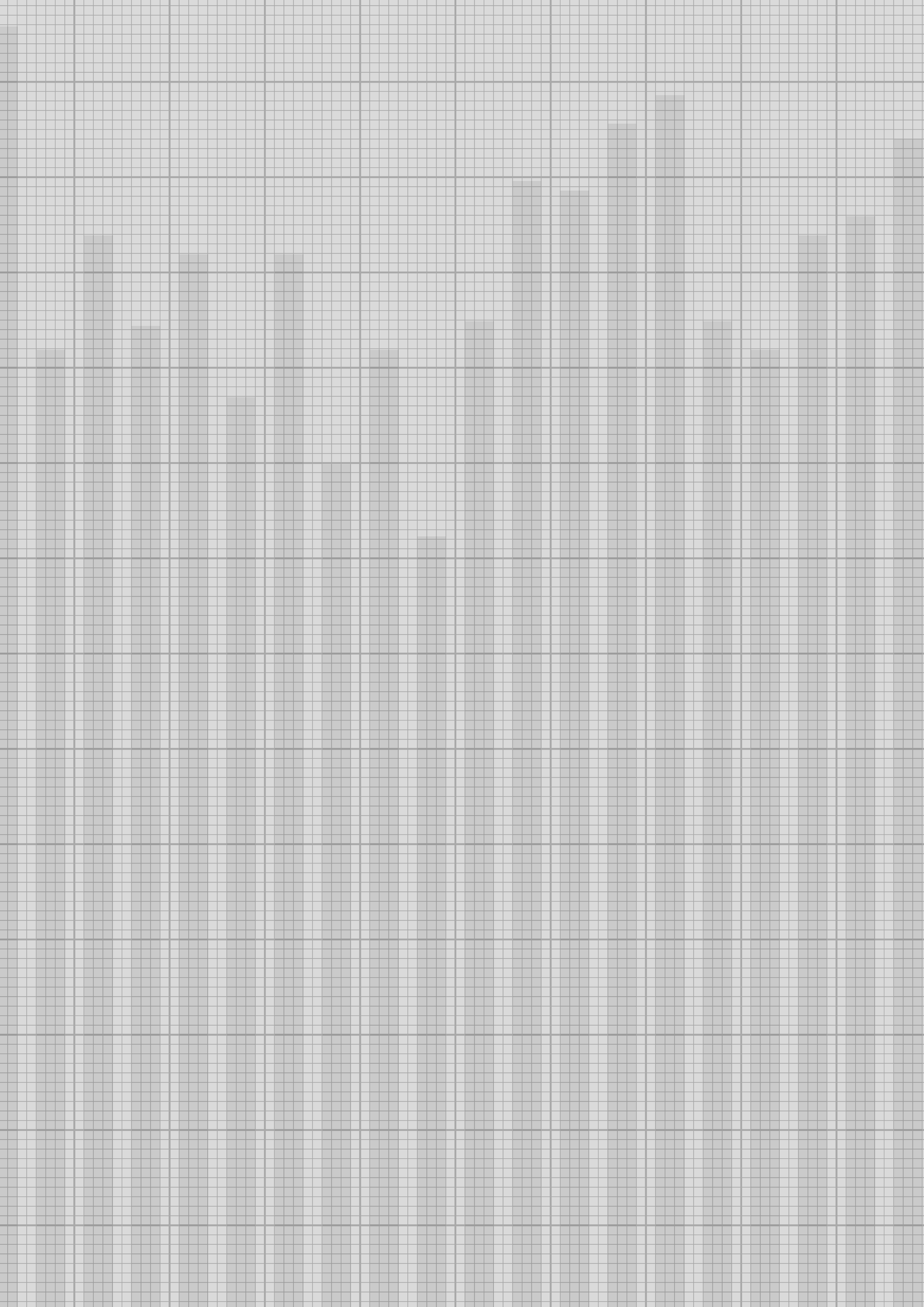
MERGERMARKET

DEAL DIMENSIONS

Taking stock:

Going public in volatile times





Foreword

To call the markets in 2016 volatile is an understatement – the slowdown in China, Britain's vote to leave the European Union and the US presidential campaign have all shaken markets around the world.

That volatility looks set to continue. As this report is published, the impact of Brexit on medium-term confidence in stock markets and investor willingness to back new issues remains to be seen. In the weeks following the referendum, the pound shifted from a US$1.50 high to below US$1.30, becoming the world's worst performer. US equity values declined and then recovered, increasing to record levels, even as interest rates dropped and the US Federal Reserve hinted at interest rate increases to come.

All of this is occurring at a time when public markets have paused to digest some of the initial public offerings (IPOs) launched in 2014 and 2015. A significant number of IPOs from 2015 are also delivering disappointing returns. As of 20 August 2016, the average return for a 2015 IPO stock was -2%, according to Renaissance Capital data – manager of IPO-focused ETFs.

However, despite the turbulence, there is reason for hope for IPOs this year. According to Rennaissance, shares of firms that have gone public in 2016 are up on average by 35%. Further, the CBOE Volatility Index, a gauge for volatility in the market, is standing at a two-year low. And our exclusive survey of C-suite executives from 100 private companies around the world demonstrates that many companies are positioning themselves to launch an IPO when market conditions stabilise, either temporarily or for a more sustained period. The attraction of going public remains strong.

While there are some differences by region as to when the IPO window will re-open, over half (58%) of respondents believe that this will happen in the next 12 months. Many companies believe that an IPO is the best route to growth, an increased valuation and a raised public profile. They understand that they will need to move swiftly as the opportunity may not be there for long – IPO windows can shut just as quickly as they open.

Our survey shows that companies are taking steps to prepare for their IPO. These steps include ensuring that financial reporting is GAAP or IFRS compliant; their corporate governance practices are more like that of a public company; and that they have shown a solid quarter-on-quarter growth or otherwise developed a compelling value proposition. There is a backlog of companies that are waiting on the side-lines for the right opportunity.

Companies that haven't begun preparing, or that aren't at the right value inflection point in their lifecycle, may find it difficult to get into a positon where they can take advantage of a period of calm in a choppy market.

While some firms may be able to achieve their listing in volatile times, there is also a need to be flexible and pursue alternatives. Even if an IPO is the ultimate end goal, volatility requires companies to consider and prepare for alternative sources of capital such as private placement, private equity funding or, perhaps, to look for a merger partner. The companies most likely to succeed are those that not only expect the unexpected, but plan for it by being nimble and keeping their options open.

Danielle Carbone
Reed Smith
corporate partner and
head of the US capital
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New York

James Wilkinson
Reed Smith
corporate partner,
London

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Methodology

In the first half (H1) of 2016, Mergermarket questioned 125 respondents employed by privately held companies with the job titles CEO, CFO or Head of Strategy, from Europe, North America and Asia. It included 100 respondents whose companies are likely to consider undertaking an IPO within the next three years and 25 respondents whose companies are not likely to consider undertaking an IPO within the next three years. The 100 respondents who had indicated that their company was likely to consider undertaking an IPO within the next three years continued to answer the full set of survey questions.

For the 25 companies that were not likely to consider an IPO within the next three years, we surveyed the alternatives to an IPO that are being considered by the respondents in this group, and two follow-up questions about the advantages and disadvantages – compared with an IPO – of these respondents' most important alternative.

The full-length survey respondent pool was comprised of the 100 respondents. They were split by geographical region in the following proportions: Europe 40%, North America 40% and Asia 20%. The respondent industry sector breakdown for each region mirrors the prevalence of the top three sectors for IPO activity during the period 2013–2016 in that region with the remaining respondents drawn from a variety of sectors. The breakdown is as follows:

- Europe: healthcare (15%), industrials and chemicals (15%), technology, media and telecommunications (TMT), (15%), other (55%) (comprised of consumer/retail (27.5%), energy, power & utilities (15%), financial services (7.5%), construction (2.5%) and transportation (2.5%))

- North America: healthcare (35%), TMT (20%), financial services (12.5%), other (32.5%) (comprised of industrials and chemicals (15%), consumer/retail (10%), transportation (5%) and leisure/hospitality (2.5%))

- Asia: industrials and chemicals (25%), TMT (15%), consumer/retail (10%), other (50%) (comprised of leisure/hospitality (20%), construction (10%), transportation (10%), aerospace & defence (5%) and energy, power & utilities (5%).

Both surveys included a combination of qualitative and quantitative questions and all interviews were conducted over the telephone. Results were analysed and collated by Mergermarket and all responses are anonymised and presented in the aggregate.

Key findings

76%
of North American executives believe IPO activity will return to previous levels within 12 months

58%
of global executives believe that IPO activity will return to previous levels within 12 months despite current market volatility

36%
have not reconsidered their decision to go public despite volatility in the global markets

73%
have altered the timing of their IPO as a result of volatility in the global markets

64%
plan to be ready to move quickly when an IPO window opens despite market volatility

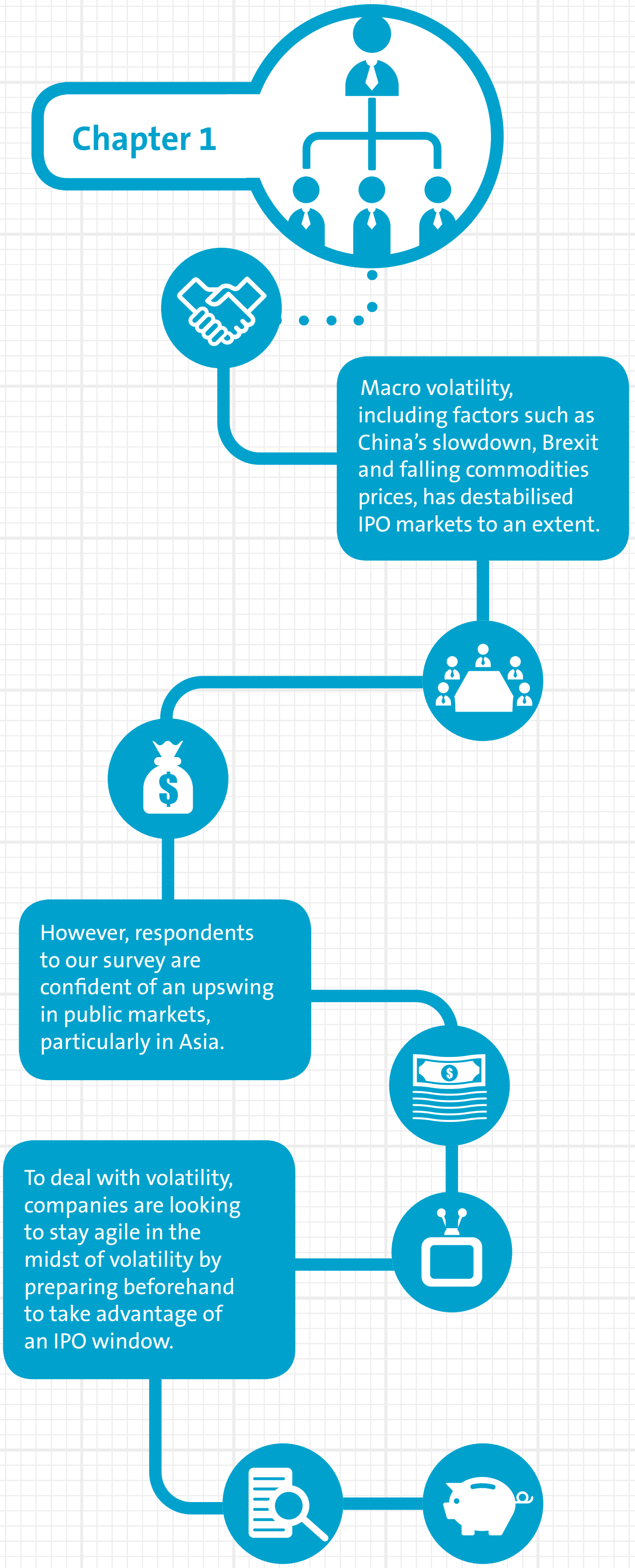
50%
believe raising their profile is one of the key drivers for undertaking an IPO

53%
state that an increase in public scrutiny is a major cause of concern in the listing process

68%
have a strategy in place to mitigate the challenge of executing an IPO in the near term

55%
have a strategy in place to mitigate their top concern about becoming a public company

51%
state that the US JOBS Act has favourably influenced their decision to go public



Sink or swim

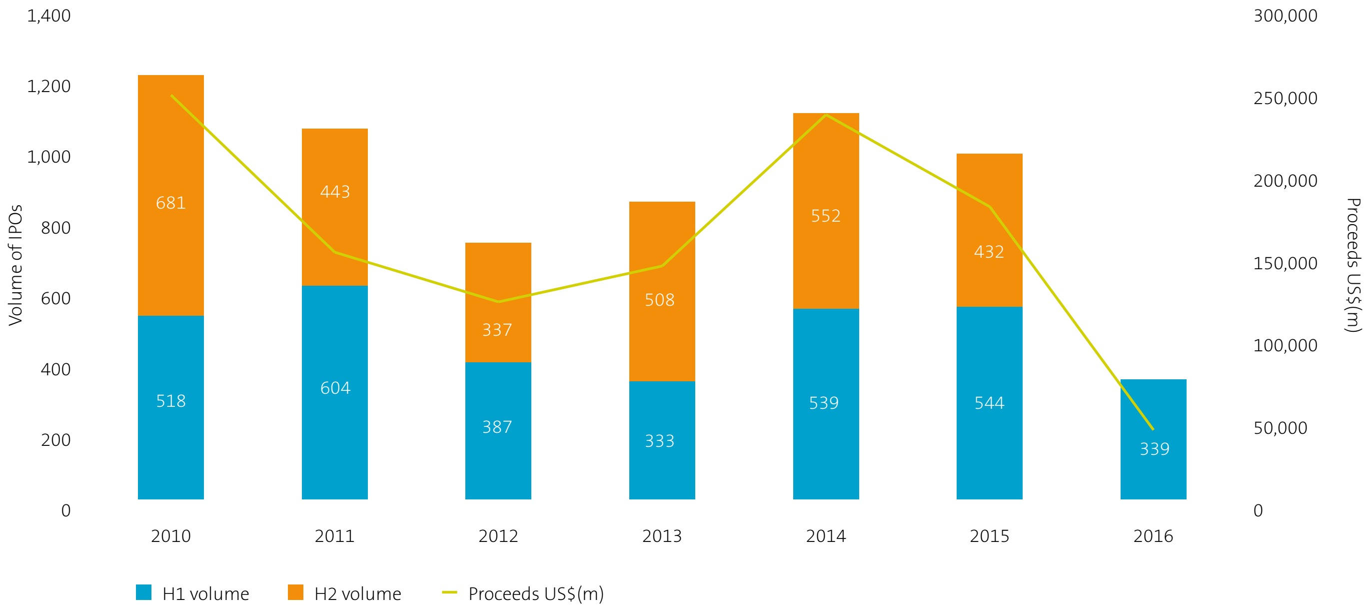
Uncertain markets are set to become even more volatile due to increasing macro uncertainty, and many companies are putting their IPO plans on hold. However, our survey reveals that there is some longer-term optimism

The appetite for IPOs has dulled considerably over the last 12 months. Global IPO volume fell by 38% from a H1 2015 total of 544 (over half the total for full-year 2015) to just 339 in H1 2016 (see figure 1.1). Indeed, cloud communication company Twilio's IPO in June 2016 has been one of the few bright spots in an otherwise difficult market for new listings in H1 2016.

The reasons for the decline have been well documented – a slowing of Chinese economic growth; muted US economic performance; poor aftermarket performance of some IPOs; and uncertainty surrounding the outcomes of both the 2016 US election and the consequences of the UK's EU referendum, where the leave result has only succeeded in ratcheting up volatility.

Overlaying these factors, the forecasts of global economic growth for 2016 have been revised downwards as the year has progressed: the International Monetary Fund, for example, downgraded its global growth estimate for the year by 0.2% in April 2016, from 3.4% forecast in January 2016, a growth rate it described as 'modest'.

Figure 1.1: Global IPOs 2010 – H1 2016



Reed Smith on globalised markets

In today's markets globally, there is an international domino effect. What happens in US markets, or decisions about the US Federal Reserve rates, for example, affects sentiment and ultimately what happens in Asia.

Denise Jong, Reed Smith corporate partner, Hong Kong

Recovery periods

While volatility in IPO markets is clearly a major consideration for many companies anticipating a new listing over the coming 12 to 24 months, our survey shows that companies globally are optimistic about the future direction of activity.

The majority of respondents (58%) foresee a return to volumes seen in the past few years within the next 12 months, with 38% suggesting this will happen in the next 24 months (see figure 1.2). Just 2% believe a recovery is further out. While these interviews were carried out before the UK referendum, respondents will have factored in, at least to some degree, the possibility of Britain leaving the EU.

The responses differ by geographic region. Among those in Asia, 11% of the companies we surveyed believe that IPO markets will recover within six months, while no European or North American respondents anticipate such a rapid rebound. This may reflect the optimism felt in some of Asia's growth markets, where more favourable economic conditions underpin forecasts from the IMF of GDP growth in the Asia-Pacific region of 5.3% for 2016. And signs that this is filtering through to public markets are already there — Line Corp, the Japanese subsidiary of South Korean internet company Naver, for example, raised over US$1.1bn with a dual listing on the New York and Tokyo Stock Exchanges.

Respondents in North America are overall the most optimistic of the three regions, with 76% believing a return to previous years' IPO levels within 12 months is possible, compared with 45% in Europe and 44% in Asia. Only 24% of North American respondents think that a recovery would take up to 24 months, and none say it would be as long as 36 months.

Reed Smith on Brexit

Concerns around China's economic growth and commodity price volatility have eased a little and the US economy is looking reasonably stable, so there has been growing cause for optimism around IPO activity. However, the uncertainty caused by the outcome of the EU referendum may delay the anticipated improvement in IPO activity on the UK markets.

James Wilkinson, Reed Smith corporate partner, London

Reed Smith on Asia

There is no shortage of desire on the part of companies in Asia to undertake an IPO. Some companies may not be quite at the right stage, but there are still a lot of investable prospects.

Matt Gorman, Reed Smith corporate partner, Singapore

Figure 1.2: IPO activity in 2016 has been low to date. When do you anticipate IPO activity in your region will return to the volumes seen in previous years?

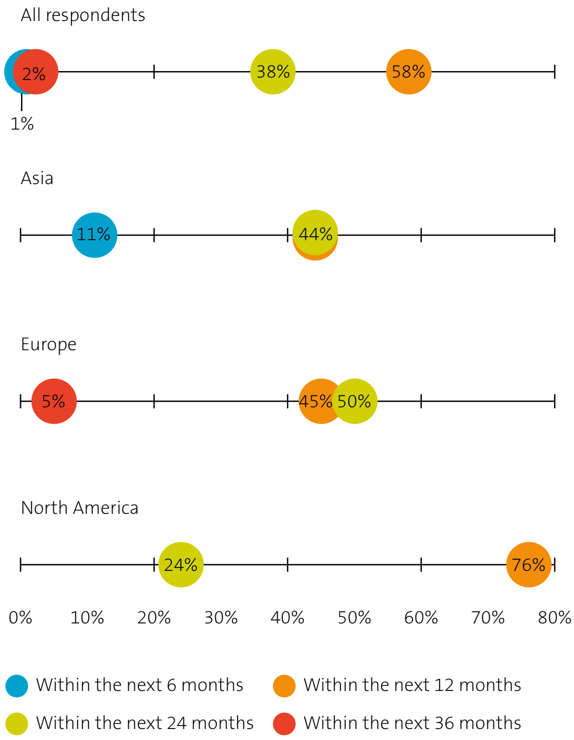
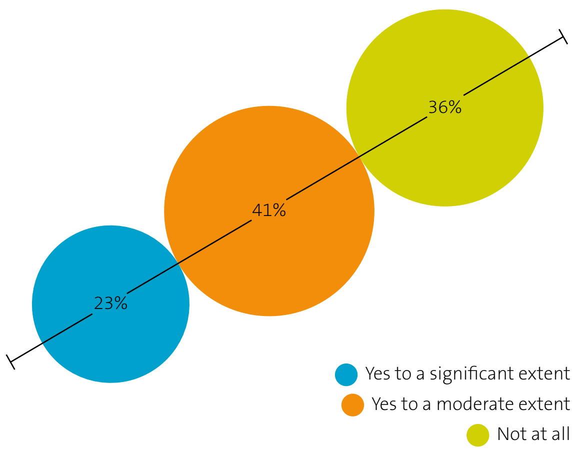


Figure 1.3: Has the recent volatility in global capital markets made you reconsider whether an IPO is the correct strategy for your company?



A change of heart

While 64% say that recent volatility in global capital markets has made them reconsider whether an IPO was the right strategy, over a third (36%) admit they have not reconsidered going public at all (see figure 1.3).

These respondents believe they are weathering the economic challenges, are well-prepared for an IPO, can achieve their desired valuation and are therefore ready to push the button. As the Senior Vice President at a US IT firm says: "We have had many rounds of funding and have been able to get good returns. For the last five years, we have been growing well and have been valued at a very high price. We are ready for an IPO and feel we need to carry it out." When a company's fundamentals are strong, it mitigates the risk of downward market pressure.

The timing of an IPO is often one of the key determinants of success. Companies need to be confident that there is investor appetite not only for their investment thesis but also for new issues generally. It is unsurprising then that a substantial number of respondents (73%) said recent volatility in global equity markets has caused them to alter the timing of an IPO (see figure 1.4).

However, encouragingly, more than a quarter (27%) say that they have not changed the timing. This could be because some companies have anticipated an IPO slightly further out and prepared accordingly. However, others may believe that the advantages of being public, coupled with the belief in their business fundamentals and sector attractiveness, means that their prospects are strong enough to weather any potential storm.

For some, market conditions have affected not just the decision of whether to proceed with or the potential timing of an IPO, but have also left some companies readjusting their expectations on valuation and offering price. Nearly half (46%) say that recent volatility in global equity markets has caused them to alter elements of their IPO strategy such as pricing to attract interest and shareholder return policies to encourage investment (see figure 1.5). The CFO of a UK retailer says: "Investors have become bearish in nature and need to be sure of returns from the investment. This kind of behaviour has forced us to reconsider our shareholder return policies."

Reed Smith on the power of preparation

Many businesses have already spent a lot of time positioning themselves for an IPO and, in the event that's not happening, to finding alternative sources of financing or to opt for a different transformative transaction. Market volatility may give pause for thought among those who are less ready, but strategy changes are less of an issue for those that are already well prepared.

Aron Izower, Reed Smith corporate partner, New York

Figure 1.5: Has the recent volatility in global equity markets caused you to alter any element of your IPO strategy other than the timing?

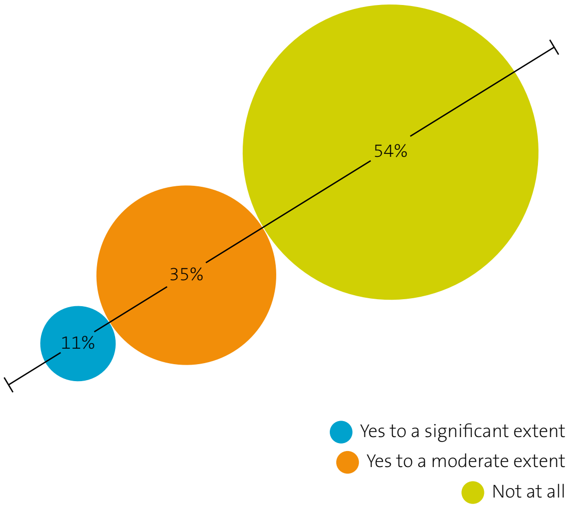


Figure 1.6: Which statement best describes your approach to global equity market volatility?

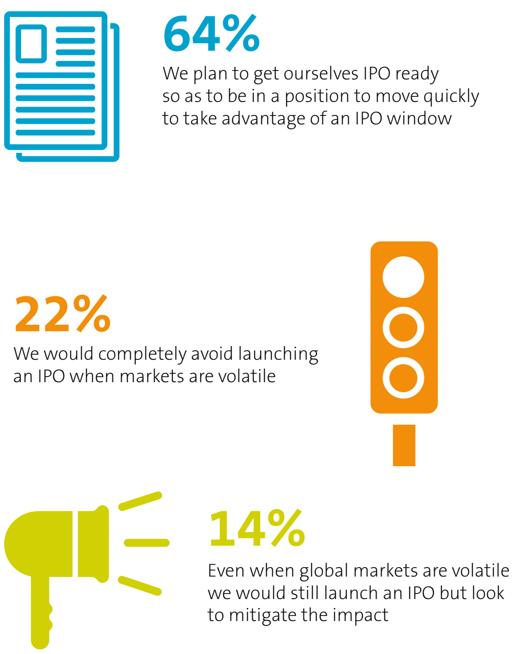
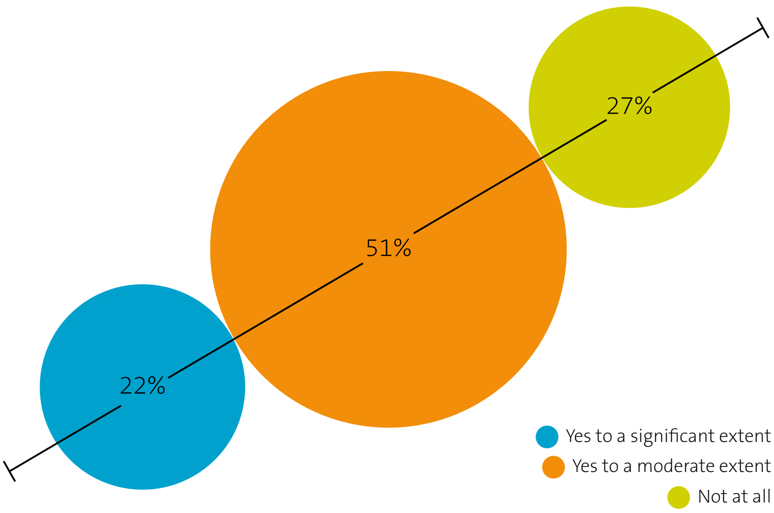


Figure 1.4: Has the recent volatility in global equity markets caused you to alter the likely timing of any IPO?



Others have moved to improve their results by focusing on operations and efforts to boost top-line growth and value, all to make their business more attractive to potential investors. “We are trying to improve the brand image of our company and have also restructured our debt to reduce the burden on the firm,” says the CFO of a German healthcare company.

Mitigating risk

Alongside revising price expectations, changing the timing and restructuring or repositioning operations, there are a number of strategies that companies can employ to mitigate risk.

Respondents note that choice of market and efforts to optimise the capital structure are mitigating factors, in addition to taking a realistic approach to pricing. “We have opted to go for a lower IPO capitalisation range which improves our prospect for IPO success,” says the CFO of an Italian chemical company.

Some companies that have already sought funding via other capital markets, such as private placements, see the process of preparing for such issuance as helpful when it comes to an IPO. The CEO of a Korean chemical company noted: “We had a successful round of pre-IPO private placements due to our continued performance and our commitment towards our shareholders and policyholders. We are confident that an IPO will satisfy our capital needs and fuel growth.”

Bringing in additional expertise in the form of advisors, making key hires, or a combination of both, and doing so at the right time, are also strategies being employed by companies in the light of market volatility. Not only can this help with ensuring IPO readiness and providing a view on when to push the button, it can also help enhance the value of the business in the eyes of investors.

Reed Smith on pricing expectations

Don’t only focus on the highest valuation possible at IPO. There will be less pressure on boards if companies go public with a realistic valuation justified by the company’s performance and prospects, announce good post-IPO results, and then see an uptick in value. Far better to have a shareholder base and investment community that is loyal because the stock is trading above the IPO price than the other way around.

Herbert Kozlov, Reed Smith partner and global corporate head, New York

Seeking alternatives

There are other options besides an IPO when it comes to raising capital – and when market conditions get choppy, exploring alternatives is key

Reed Smith on alternatives

Giving consideration to or taking the initial steps towards an IPO can in some instances produce a different outcome – a strategic sale may be an easier option for those seeking an exit. Prospective buyers may seek to close an acquisition before an IPO when public company valuations kick-in, and early stage investors may find that a sale of the company – and immediate liquidity – is preferable and avoids the uncertainty of undertaking an IPO.

James Wilkinson, Reed Smith corporate partner, London

Companies always need to be considering alternatives, and being flexible becomes even more important in volatile times. If raising capital is the key consideration and the public markets are closed, companies will have to pursue other capital raising strategies in the meantime, even if an IPO is still the long-term goal.

Aron Izower, Reed Smith corporate partner, New York

When it comes to IPO alternatives, the most popular routes were debt finance or self-finance (using company cash reserves), according to 60% of all companies (see figure 1.7).

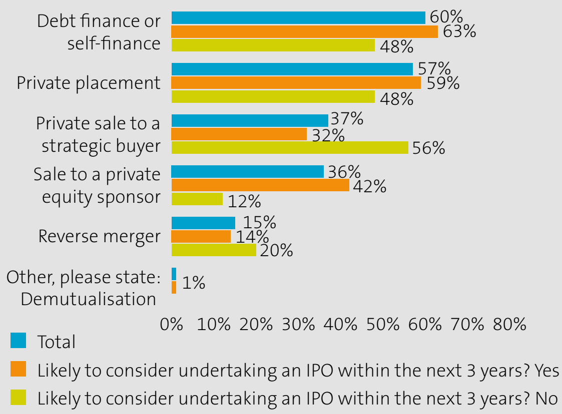
Private placements were also high on the list of alternatives, with 57% of all respondents considering them. As the CFO of a Finnish consumer business comments: "A private placement is quick and will allow us to continue to function as a private company – free from public and regulatory scrutiny."

Yet private placements don't suit everyone, and, indeed, over half of respondents not likely to undertake an IPO in the next three years said they are unlikely to consider one as an alternative. Reasons for not following this strategy include the expense.

"Private placement issuers will frequently have to pay higher interest rates to attract investors," says the CEO of a UK retailer. "Private placements can be more challenging because valuations are more difficult, there is greater risk because there is no liquidity and they usually involve debt or preferred stock that can be more expensive than equity."

While a sale to a strategic buyer was much lower down the list overall, with 37% of all respondents citing this as a possible alternative, this route was much more popular among those not considering an IPO (56%) than those who were (32%). A sale to a private equity sponsor is the fourth most popular alternative (cited by 36% of all respondents), although much more so among those considering an IPO (42%) than not (12%).

Figure 1.7: Which of the following alternatives to an IPO are you considering/likely to consider? (Select all that apply)



Regional differences

Despite the increasing interconnectedness of the global IPO markets, there are some subtle differences in each region

In Europe, the first half of 2016 saw a significant drop in activity, falling 28% to 92 from the 128 IPOs in the first half of 2015. Total proceeds raised dipped even more dramatically from over US$60bn for the whole of 2015 to just over US$15bn in the first half of 2016.

This pattern reflects the appetite for large technology offerings in the first half of 2015, such as the Auto Trader Group, which raised nearly US$2.4bn on the London Stock Exchange.

However, this was followed by the subsequent drop in popularity of tech IPOs in Europe as investors sought to digest and temper their exposure to the sector. In 2015, 7% of European IPOs raised US$1bn+; in 2016, only a handful of IPOs have raised US$1bn or more, including Danish wind farm company DONG, which raised US$2.5bn in a June 2016 listing. Uncertainty around the precise effect of Brexit on the wider European economy suggests that few companies are likely to opt for IPO in the near term.

In Asia, IPO volume fell by 34% from 297 in H1 2015 to 195 in H1 2016, reflecting concerns around the slowing of the Chinese economy and outflows of capital away from emerging markets. Yet Asia remained the most active of all three regions in 2016, with the Chinese, Hong Kong and Japanese exchanges seeing the highest volumes. Japan's Line Corp produced the largest global technology IPO so far in 2016 when it listed in July, raising US$1.1bn.

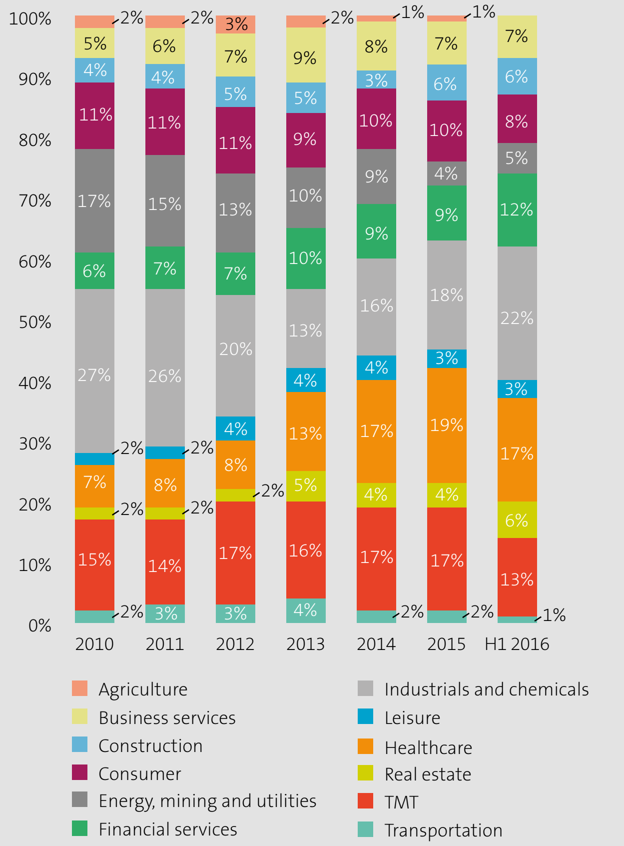
North America saw the biggest fall in volume of all regions, declining 60% in volume from 106 IPOs to just 42 in the second half of 2016, compared to 163 IPOs in the first half of 2014. Potential rate rises, the poor performance of past IPOs and general economic conditions are all factors weighing on the minds of investors in US public markets. Yet some big IPOs were still able to get off the ground, such as US Foods' US$1bn offering on the NYSE in May.

Sector shifts

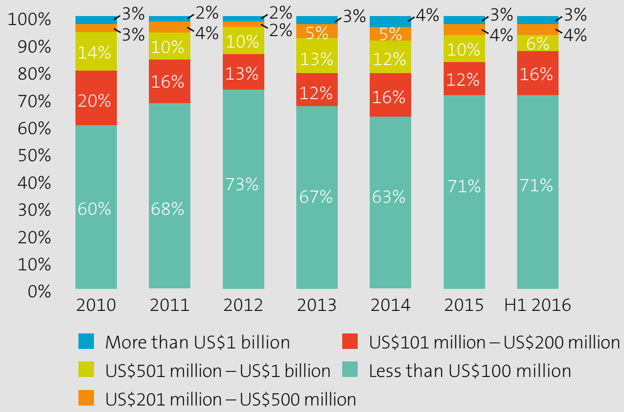
Financial services and healthcare are the two industry sectors that have seen an increase over recent times as a proportion of overall IPO activity by number. The proportion of financial services firms opting to list by number was 12% in H1 2016, compared with 7% in 2011. The proportion for healthcare has been 17% to 19% between 2014 and 2016, up from single digit percentages before 2013. Recent listings in these sectors include UK-based Clydesdale Bank, which floated on the London Stock Exchange in early 2016, and Intellia Therapeutics, which went public on the Nasdaq in May this year.

Both industries are undergoing a high degree of change – in financial services, disruptive technologies, combined with additional regulation, are leading many companies to seek new capital, while in healthcare, the need for scale and innovation is driving M&A activity more generally.

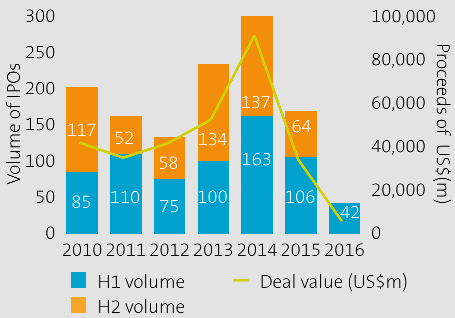
Percentage of IPOs by sector 2010 – H1 2016



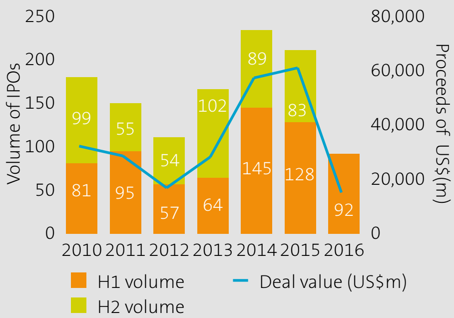
Global IPOs split by proceeds



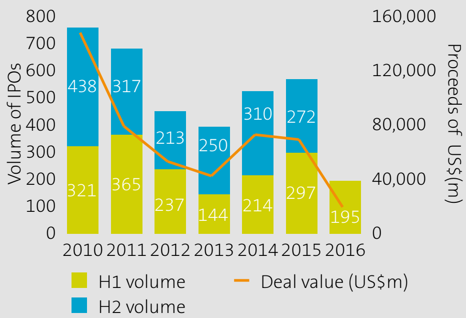
North American IPOs 2010 – H1 2016

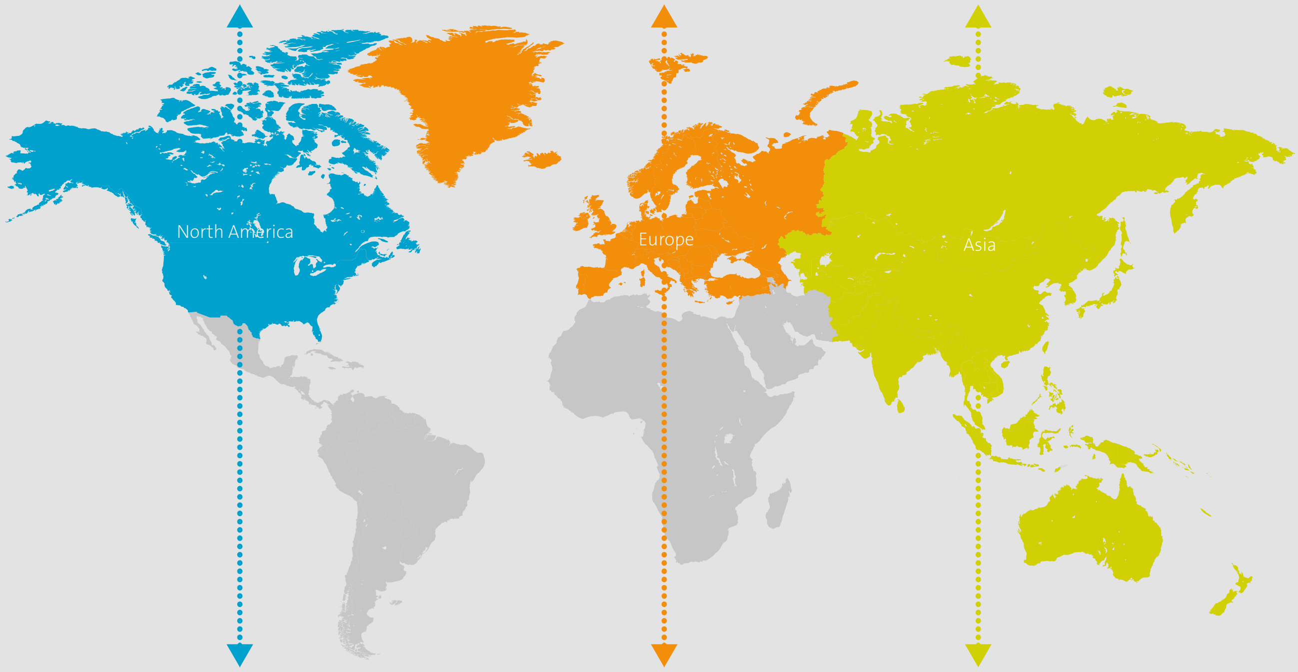


European IPOs 2010 – H1 2016

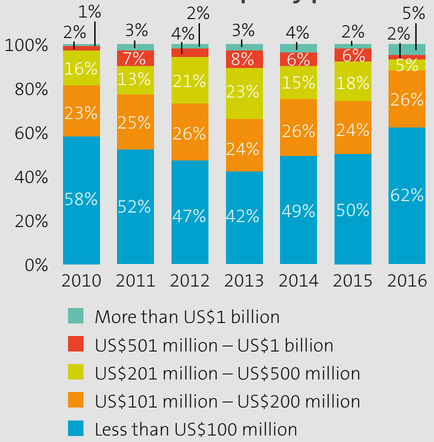


Asian IPOs 2010 – H1 2016

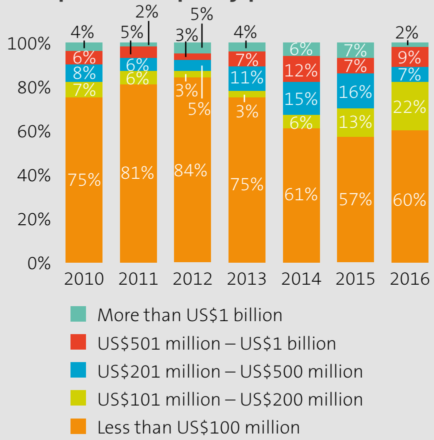




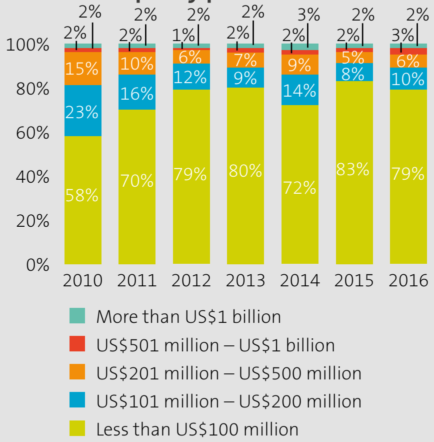
North American IPOs split by proceeds



European IPOs split by proceeds



Asian IPOs split by proceeds



Preparing for launch

Because of market volatility, corporates need to be prepared to move swiftly when markets are receptive to a new issue

When it comes to IPOs, motivation and preparation must go hand in hand. Ensuring your rationale for going public is sound and fits in with your overall business strategy is also key.

Our survey reveals that firms are not just focusing on short-term cash boosts, but are positioning their companies for future growth. Indeed, while the most important motivation for respondents in seeking an IPO was to raise cash – 35% said it was the top consideration, with 64% mentioning it in the top three – respondents noted that there are many more advantages to going public beyond simply raising capital (see figure 2.1). Raising the company's profile is also a key motivation, with 50% ranking this as a top-three driver, including 15% who believe it was the most important factor. Not far behind is gaining a better valuation as a public company, seen by 47% as a one of the three most important drivers, with 15% ranking it the top.

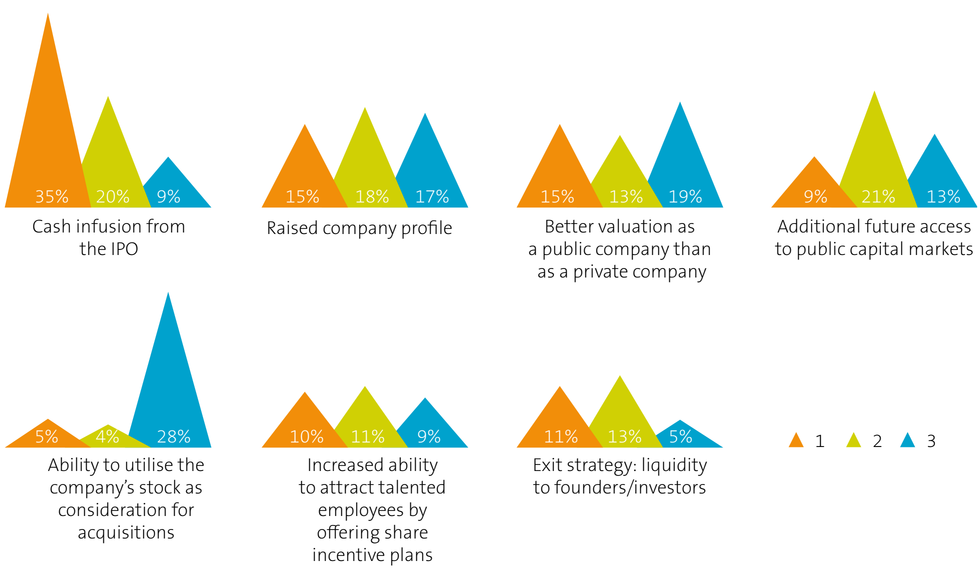
The other key considerations mentioned by respondents suggest companies have their sights firmly set on their future strategic goals, such as having access to public markets for future capital raising (43%), the ability to use the company's stock for acquisitions (37%) and an increased ability to attract employees (30%).

Split decisions

Interestingly, there are some variations in key drivers when we explored the relative size of the company's IPO. For example, 50% of companies planning an IPO of less than US$100m are motivated most by an increased ability to attract personnel through share incentive plans, compared with just 10% of overall respondents (see figure 2.2). This suggests that smaller companies are relying more on equity to incentivise and attract employees who will see the prospect of an IPO as a compelling reason to join an emerging company.

Another divergence is the 25% of respondents with IPOs expected to raise US$501m to US$1bn that say their top driver is to provide

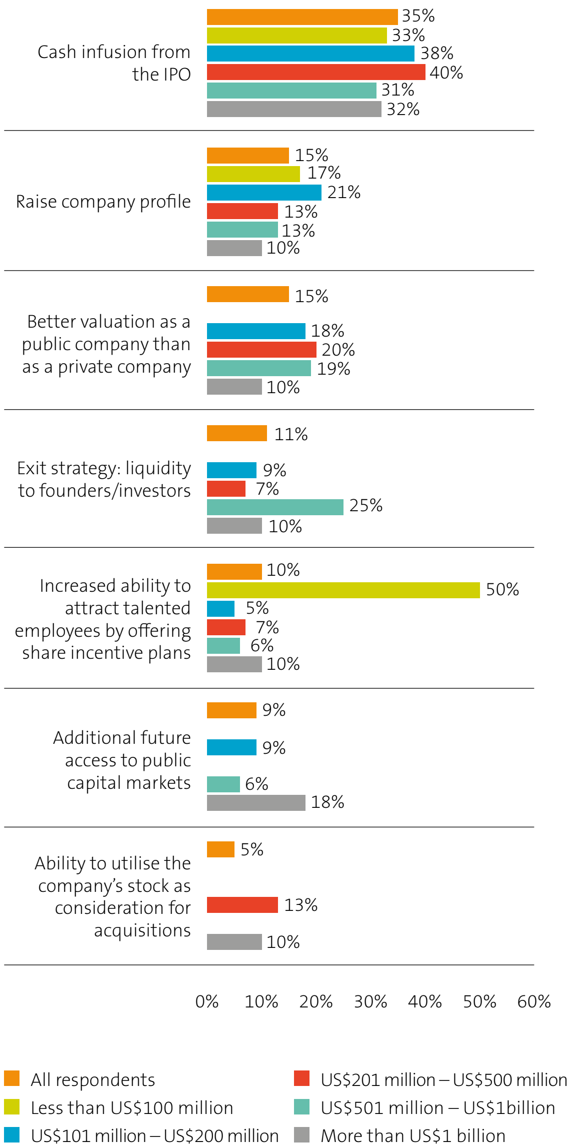
Figure 2.1: What are your key drivers for undertaking an IPO? (Rank the top three, where 1 = most important)



While most firms preparing have completed necessary tasks such as obtaining audited financial results and assessing listing standards, some are behind on tax planning and appointing independent directors and committees.

Given that many respondents are concerned about increased public scrutiny and negative publicity, covering these areas is key.

Figure 2.2: What are your key drivers for undertaking an IPO (top choice shown)? By anticipated size of the company's IPO (Q.15)



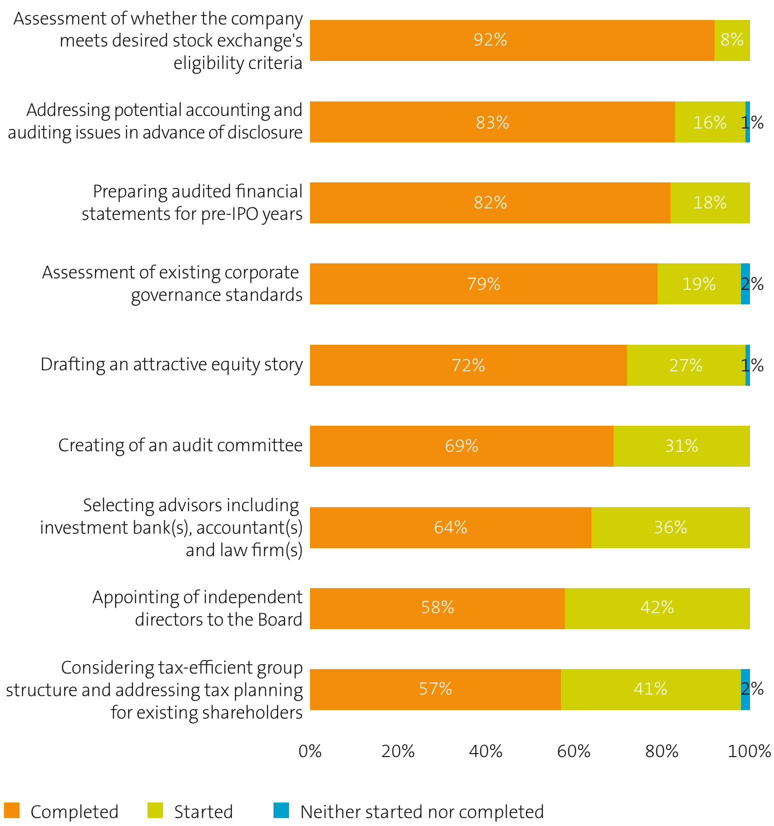
an exit strategy: liquidity to investors. This compares with 11% of respondents overall and just 7% of respondents in the US$201m to US$500m bracket.

Laying the groundwork

Overall, the responses to our survey suggest that companies are taking the necessary steps to prepare for an IPO. However, companies are still at diverse stages of preparedness.

Among the list of preparations essential for an IPO, the assessment of whether the company meets their desired stock market's eligibility criteria has been completed by the vast

Figure 2.3: Turning to your corporation's preparations for its IPO, which of the following has your company currently started or completed?



majority, with 92% of respondents saying this (see figure 2.3).

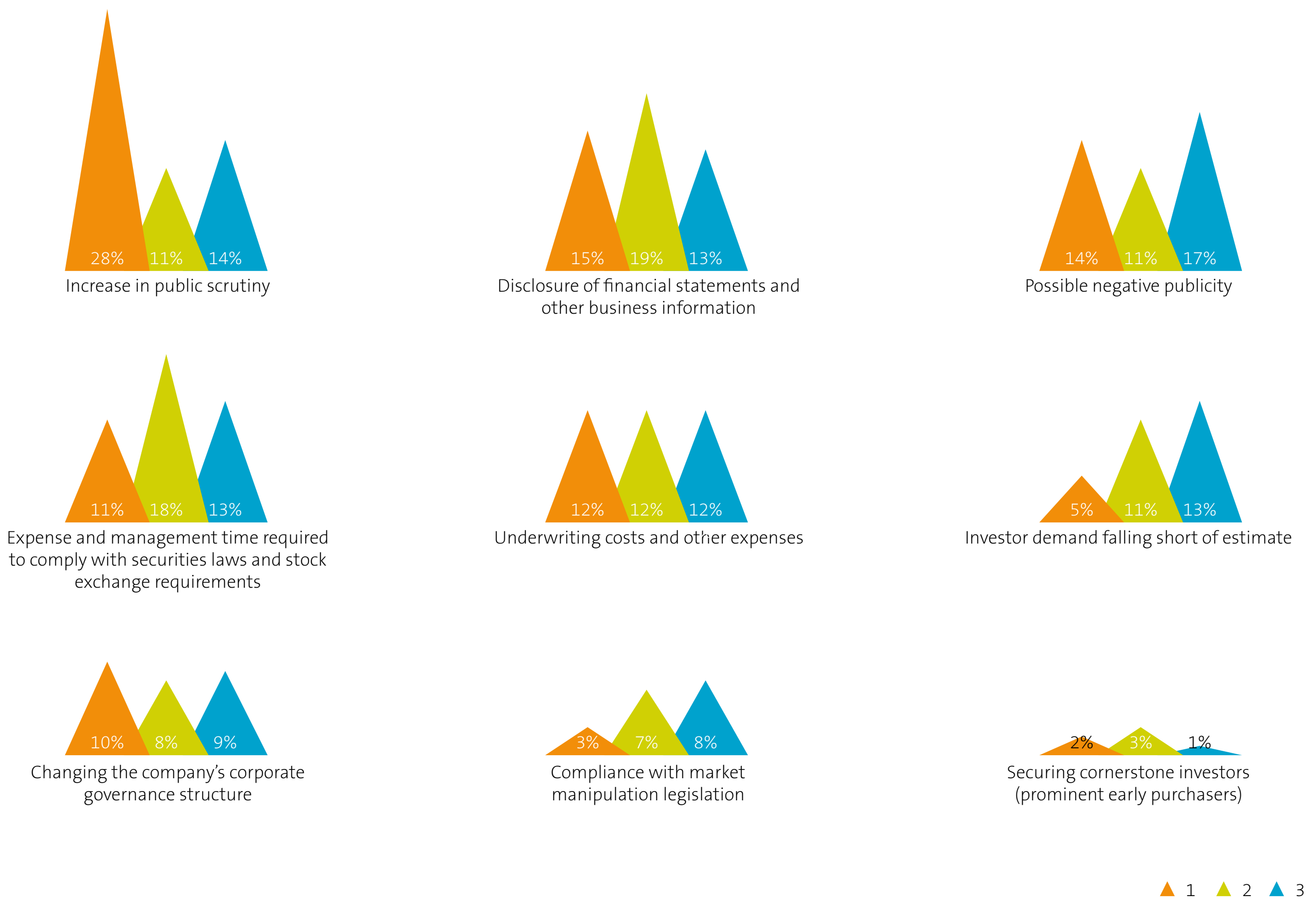
The signs that companies are well on their way to addressing potential accounting and auditing issues ahead of disclosure (completed by 83%) and obtaining audited financial results for pre-IPO years (completed by 82%) are also positive.

Nevertheless, many companies appear to be less well prepared when it comes to some other areas. For example, considering tax-efficient structures and addressing tax planning for existing shareholders has been completed by the fewest respondents (57%). Meanwhile, 41% have started considering this and 2% have neither started nor completed it.

While the majority of respondents (64%) have selected a team of advisors, over a third (36%) have not. Investment bankers, accountants, law firms and investor-relations firms are all critical to the success of an IPO, given their experience in guiding a company through the complexities of the listing process. Building relationships well before the listing with the right advisors can ensure a smoother and more cost-effective path to IPO.

For details on how the US has made it easier for emerging growth companies to lay the groundwork for an IPO, see *Listing in the US*, page 23.

Figure 2.4: What about the IPO/listing process is a cause of concern to you? (Rank the top three, where 1 = most important)



Reed Smith on setting boundaries

It's really important to determine, from an early stage, which exchange best suits your requirements. This will determine the conditions that you'll need to satisfy at the point of listing and the post listing obligations, in terms of financial reporting requirements, governance commitments and standards, and issues relating to the constitution of the company (and equity available).

James Wilkinson,
Reed Smith corporate partner, London

Reed Smith on becoming a public company

Private companies that put corporate governance practices in place and approach the governance standards of public company listing requirements not only benefit from those practices while they are still private, but will need to spend less time focusing on them during the listing process and may have a smoother transition to public company life.

Public scrutiny and the risk of negative publicity should not prevent a company from seeking a listing, because the benefits of being a public company often outweigh these risks. The risks are also very manageable. Strong disclosure controls and procedures, a top-down culture of compliance, careful consideration of significant disclosure issues facing the company and clear, complete and timely disclosures of those issues are the best ways to protect against challenges from investors who say they did not have information that they would consider important in making an investment decision.

Danielle Carbone,
Reed Smith corporate partner,
New York

Listing concerns

While respondents clearly see major benefits in becoming a public company, their main hesitations focus on how the offering and the company will be received by the market.

Chief among these was the increase in public scrutiny, ranked in the top three by over half (53%) of respondents, including 28% who say it is their main concern (see figure 2.4). Public disclosure of details around business operations and financial results also cause some uneasiness. Nearly half (47%) cite this in their top three concerns.

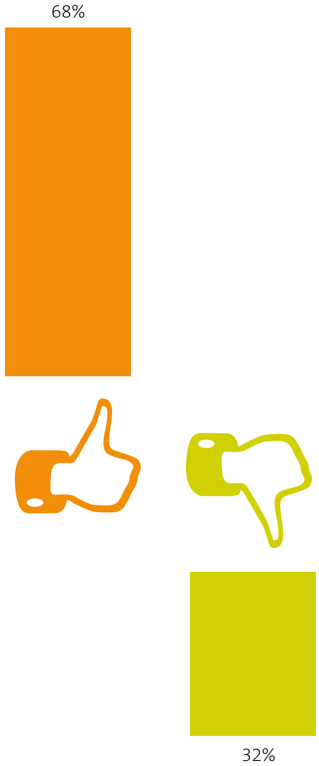
With a public profile comes the risk of possible negative publicity – a top-three concern for 42% of companies. For many firms, preparing public reports on a timely basis is a new undertaking that requires a significant investment of management resources, and the pressures of meeting earnings estimates is considerable.

Smoothing the waters

The risks identified above are manageable, as long as companies seek to employ the appropriate strategies to mitigate them. The majority (68%) of respondents say they currently have such a strategy in place to help them manage their top concern (see figure 2.5). Tellingly, however, nearly a third (32%) say they do not.

Drilling down further, among those who were most concerned about public scrutiny, strategies included being as transparent as possible, ensuring that a high-quality investor relations team is in place and using advisors.

Figure 2.5: Does your company currently have a strategy in place to mitigate the effects of your top choice?



For those worried about negative publicity, it is a case of making sure the company's public image is well maintained and managed by having a leadership team who have credibility in the market, as well as the right people who are experienced with dealing with the media.

The decision about where to list determines the scope and nature of compliance obligations for the offering process and as a public company – and should be one of the first considerations for any company. Among the respondents, the vast majority (94%) say they are most likely to choose a stock exchange in the same country as their company's headquarters as their primary listing (see figure 2.6).

When asked further about the reasons for considering a particular stock exchange, over half (58%) say the fact that it is located in the company's major market for its goods and services is a top-three factor, including a third that think this is the most important reason (see figure 2.7).

The desire among many respondents to increase the company's profile in the region of the stock exchange was another determining factor. This is a top-three reason for 44% of respondents, with 15% saying this is the primary rationale.

Also important to respondents is access to deeper pools of capital, which ranked joint third overall in importance with prestige or credibility of the listing on their stock market of choice (both cited by 43% of respondents).

Reed Smith on commercial agreements

If you're considering an IPO, you really need to think about all the agreements you enter into and how they would be perceived in the public markets – that's everything from debt packages and management services agreements, to contracts with customers and suppliers. When executing agreements, think ahead to identify confidential information that may need to be redacted when it comes to public disclosure without the need for lengthy discussions with the counterparty.

Aron Izower, Reed Smith corporate partner, New York

Reed Smith on exchange choice

Deciding which stock exchange to choose for your listing will depend on a number of factors. At the outset, consider whether your company meets the initial listing criteria of the exchange as well as the continued listing standards. Whether the company can achieve a higher valuation on one exchange versus another is, of course, the most important consideration. Pursuing a domestic or international listing or dual listing are also key considerations, again dependent on your business and where you see the most robust investor base.

Danielle Carbone, Reed Smith corporate partner, New York

Figure 2.6: Is this stock exchange located in the same country as your company headquarters?

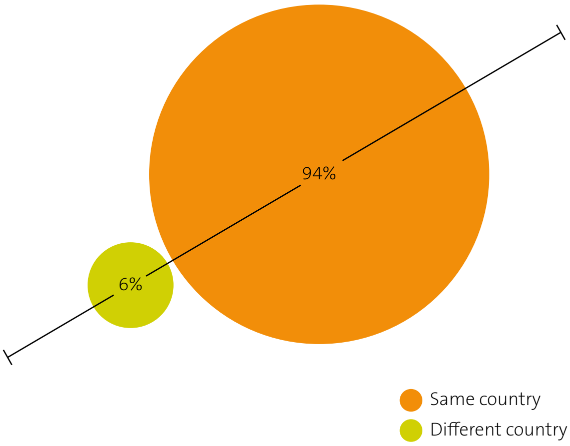
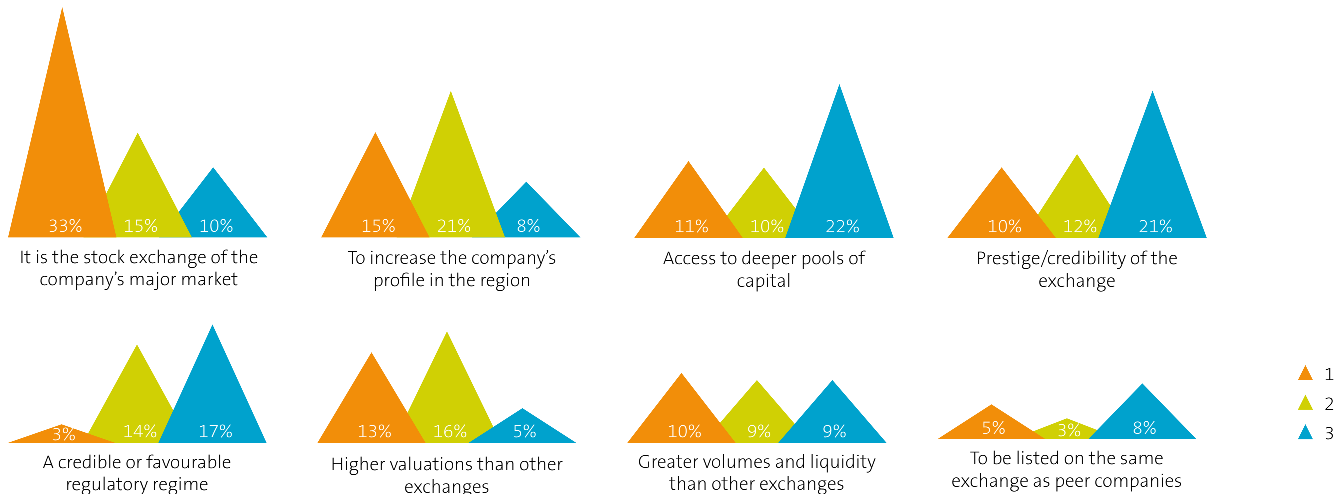


Figure 2.7: Why are you considering listing on this stock exchange? (Rank the top three, where 1 = most important)



Successful IPOs in volatile times

Brexit, US elections, a slowdown in China and US economic concerns have increased levels of uncertainty, but volatile periods are not new and successful IPOs still happen

Even in the most volatile times, IPOs still get done successfully and there are a number of examples of successful listings in tumultuous times. Indeed, in the midst of the 2007/2008 Financial Crisis, Visa went to market with what was then the biggest IPO in US history, raising US$17.9bn for the financial services giant. On the day of launch, in March 2008, shares in the company rose by as much as 28%.

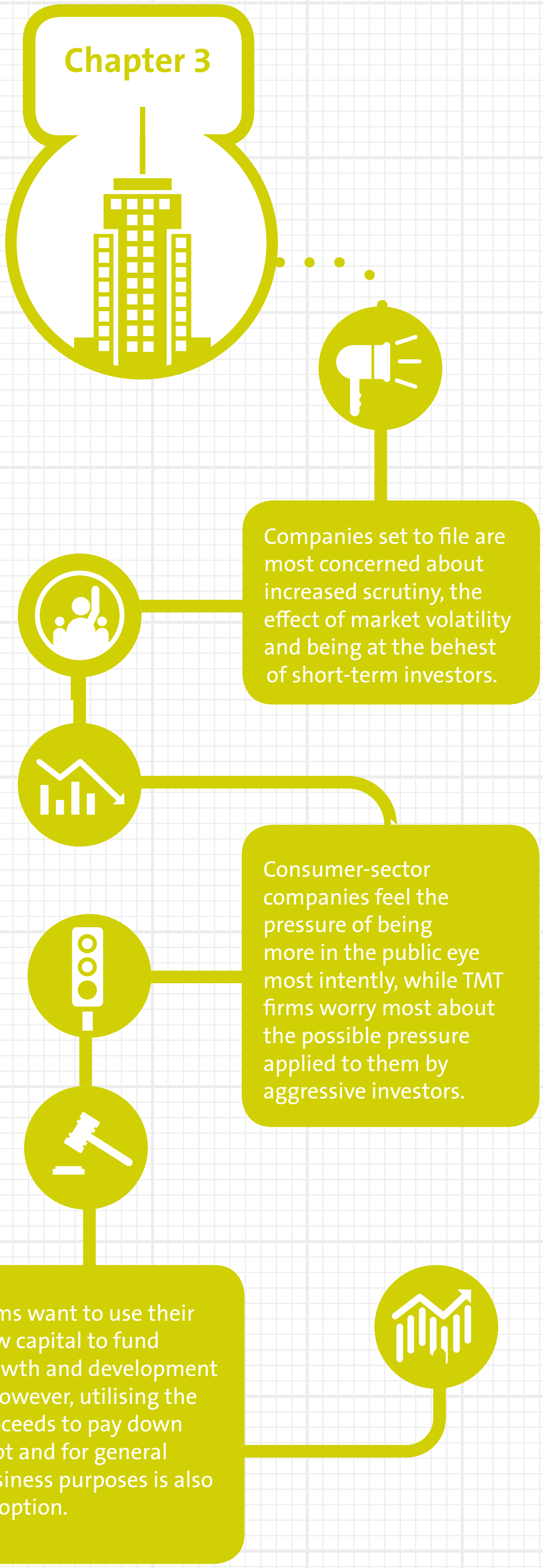
While it may seem to have been a curious time to undertake an IPO, the fact Visa was able to do so successfully highlights the fact that company fundamentals are often more important than market conditions when choosing to list. A strong brand, a recent rate cut and high growth prospects all helped to convince investors to take part.

More recent times have also generated success stories, with many of the larger IPOs launched between Q4 2015 and Q1 2016 emanating from China and Japan, such as Japan Post Bank and China Huarong Asset Management. In Europe, wind turbine maker Senvion first announced it was dropping plans for an IPO in March 2016 because of a lack of investor appetite, only to re-launch a week later, having dropped its target price – from between €20 and €23.5 to a final offer price of €15.75. Realistic pricing was a factor in this case, but so was a determination to list.

The first half of 2016 saw many IPOs pulled, with 17 companies globally shelving their plans to list by the end of Q1 alone – this is the highest proportion of pulled deals (10%) since 2007, according to Dealogic data. The number of deals pulled or still on hold is likely larger, but the complete data is unavailable because confidential filings with the SEC are permitted.

US-based Petco abandoned a listing after receiving an offer from private equity investors, led by TPG. Wayne Farms also announced it was no longer planning to list – for the second time in less than a year – in March 2016.

Yet despite this, quality offerings are still getting traction this year. DONG Energy, 2016's largest IPO so far, listed on the NASDAQ OMX for US$2.6bn in June, while MGM Growth Properties — the real estate investment trust behind MGM Resorts International — raised over US$1bn after its April listing on the NYSE. And with a bulging IPO backlog, the market could be set for a busy period in the coming months.



Setting sail

While the run-up to an IPO will necessarily mean focusing on preparing for the transaction, companies also need to think longer term about what being public will mean for the business

Having the motivation and preparing for an IPO, particularly in uncertain times, is half the battle. Private companies also need to plan for life as a public company. They have to weigh the pros (tapping the markets for capital to fund growth and development, plus increased liquidity in shares) and the cons (greater scrutiny, share price fluctuation, increased costs and the possibilities of shareholder pressure and even litigation). Companies need effective ways of managing the burdens of being a public company well before the IPO launch.

Pressure in the public eye
Mirroring respondents' hesitations about the listing process itself, their biggest reservation about being a public company is greater public scrutiny and the loss of confidentiality because of reporting requirements. Fifty-nine per cent of respondents identify this among their top three most important reservations, while 23% see it as the most important (see figure 3.1).

The second biggest reservation focuses on share price: just over half (51%) say concern about their stock being subject to market volatility ranks in the top three. Short-termism/shareholder pressure and the risk of litigation also feature highly in the list of reservations about being a publicly listed company.

Figure 3.1: What reservations do you have about the prospect of your company being a public company? (Rank the top three, where 1 = most important)

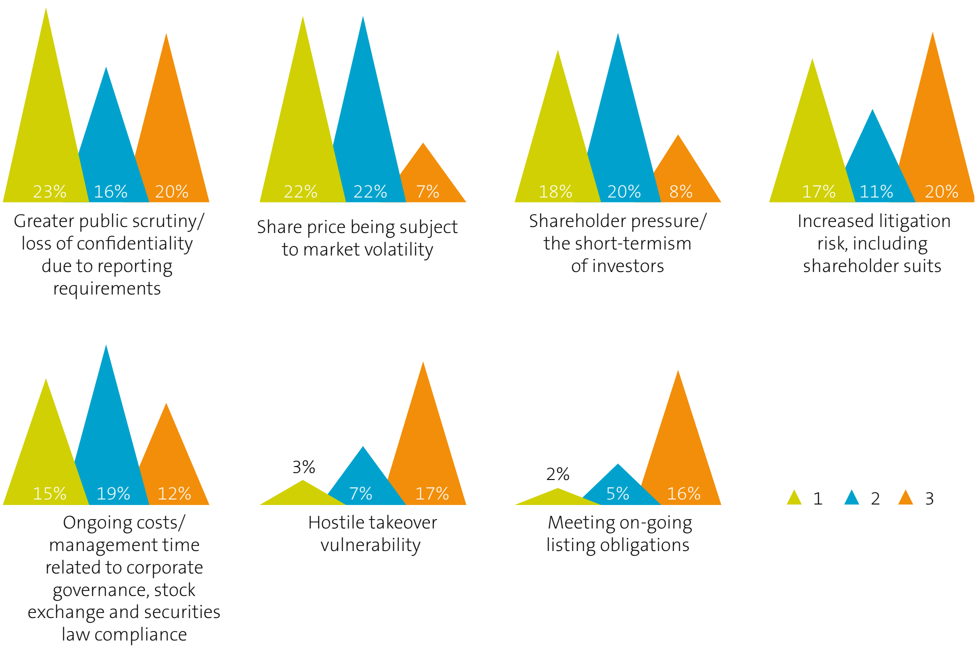
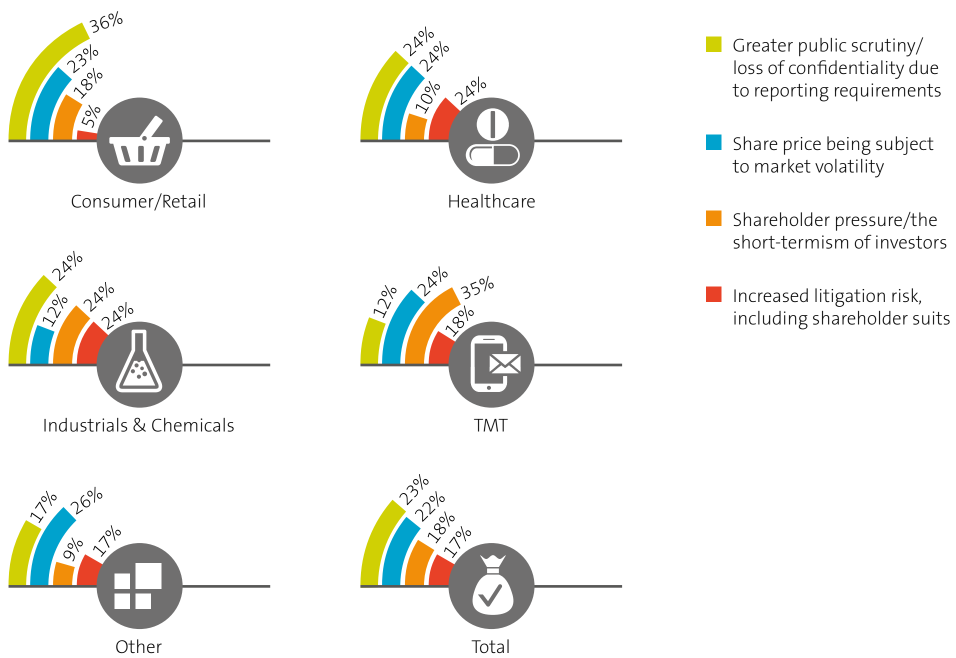


Figure 3.2: What reservations do you have about the prospect of your company being a public company? (Four most popular choices shown only)



Indeed, it is surprising that this was not more of a concern, considering how investor activism has grown over the past few years. For example, in 2015, the number of companies subjected to activism reached 551, up 16% from 2014, according to The Activist Investing Annual Review 2016. "Shareholder pressure may cause companies to shift focus from core operations, affecting flexibility and obstructing core decision-making," says the CFO of a US-based drug firm. "The short-termism of investors is something that we are highly concerned about."

Reed Smith on investor activism

Shareholder activism often confronts companies that either have been unwilling to implement corporate governance best practices, or have not delivered adequate shareholder returns. If you perform and have the right corporate governance set up from the beginning, shareholder activism is far less likely to derail your company. And, there are reasonable governance practices boards can adopt to help insulate against whimsical shareholder activists.

Herbert Kozlov, Reed Smith partner and global corporate head, New York

Sector scrutiny

On a sector basis, there are some interesting variations in the results (see figure 3.2). For example, consumer and retail businesses are more concerned about the greater public scrutiny that comes with listing, with 36% citing this as the top concern, compared with 23% overall. TMT companies have most reservations about shareholder pressure and short-termism (compared to 18% overall).

It seems likely that the principal concerns among retail and consumer businesses are a reflection of the disclosures that need to be made as a public company – and for this sector margins, concentration of revenue, dependency on vendors and material agreements are viewed as commercially sensitive.

For TMT companies, the reservations possibly stem from the spate of shareholder activism in some markets, most notably the US, that has been focused to a degree on technology businesses. A 2016 Boston Consulting Group report found that the average S&P 1500 company has a 13% chance of becoming an activist target, while the proportion for technology companies is higher, at 22%.

Overall, these responses are all linked to concerns around a perceived loss of control about aspects of business management. Yet a well-run and advised firm should be able to avoid being subject to most, if not all, of these pressures.

Nevertheless, when asked whether they have a strategy in place to mitigate the effects of their top reservation of being a public company, almost half (45%) say they do not (see figure 3.3).

Figure 3.3: Does your company currently have a strategy in place to mitigate the effects of this factor?

Among those most concerned about shareholder litigation, the CEO of an Asia-Pacific chemicals company says: "We have proper frameworks and measures to mitigate the risk of litigation. We follow all the relevant laws and regulations that are imposed on a public company. We also have strict safety and security standards which we adhere to and that reduce our chances of facing litigations and lawsuits."

For those who mentioned management time and costs, respondents with a strategy have identified any areas of potential weakness and worked to address these; or have identified a panel of experts to define and implement codes of conduct and policies.

The CFO of a US healthcare firm, with concerns about the risk of hostile takeovers, says the company has a well-rehearsed plan. "To avoid hostile takeovers, we have articulated various strategies," he says. "We can exercise a shareholder rights plan or voting rights to avoid any prevailing vulnerabilities. We can also consider increasing shareholder and board benefits to mitigate these risks."

Cashing in

Most companies are looking to use the proceeds of an IPO to invest in capital expenditures. The vast majority (83%) say they plan to use over 30% of capital raised for this purpose, including 56% who are planning to deploy 31-45% of the proceeds on this and 1% looking to allocate as much as 61-70%.

Research and development is another area for investment, with 8% suggesting they will spend 31% or more of the proceeds on this and 40% who will allocate between 16% and 30%. Sales and marketing are set to receive up to 15% of the proceeds in the majority of cases (87%) and a similar percentage (85%) have the same proportion earmarked for corporate acquisitions.

All the above areas suggest companies are seeking an IPO to fund growth and development of the company. However, companies are also looking to public markets to finance other activities. General corporate purposes ranked relatively highly, with 58% saying they would spend 16% or more on this and 51% that they would allocate over 16% to paying down debt.

Listing in the US

How has the JOBS Act affected IPOs in the US?

We spoke to respondents planning to list in the US to garner their views on the extent to which regulatory changes under the Jumpstart Our Business Act of 2012 (the so-called JOBS Act) has affected their views on the markets and their process for listing.

Under the JOBS Act, companies that meet the definition of emerging growth companies can submit a registration statement for an IPO on a confidential basis to the SEC, a change that was intended to encourage more IPOs in the US markets by allowing these companies to get through the SEC review process without disclosing publicly their plans to list.

Among our respondents, 38% say they have already submitted registration statements with the SEC on a confidential basis, with a further 49% saying they plan to do so (see figure 3.4). This suggests a high degree of support for this measure, as does the response to the question of whether the confidential nature of the submission mitigates some of the risk associated with the IPO process, as over two thirds (67%) say it has.

The response to whether the accommodations offered by the JOBS Act had influenced respondents' decisions about whether to go public also suggests a fairly high level of support for the measures, as just over half (51%) believe this to be true (see figure 3.5).

Respondents point to the confidential nature of initial company filings as a particular attraction. "The JOBS Act has somewhat motivated us to go public since it offers the benefit of filing company papers with the federal regulatory bodies without full disclosure," says the CFO of a US technology company. "The JOBS Act also doesn't force companies to disclose documents until just before the IPO launch which can give companies enough time to gauge their market strengths and weaknesses."

Among the 49% who say it hasn't influenced their decision of whether to go public, most believe the decision had been driven mainly by strategy and the aims of the business rather than any regulatory changes.

The JOBS Act, which also provides for less onerous disclosure obligations for emerging growth companies, has boosted the IPO markets in the US. While IPO activity has been volatile over the last few years, since the enactment of the JOBS Act approximately 85% of all IPO companies have been emerging growth companies, according to SEC filings.

Figure 3.4: Are you planning to submit or have you already submitted a draft registration statement with the SEC on a confidential basis?

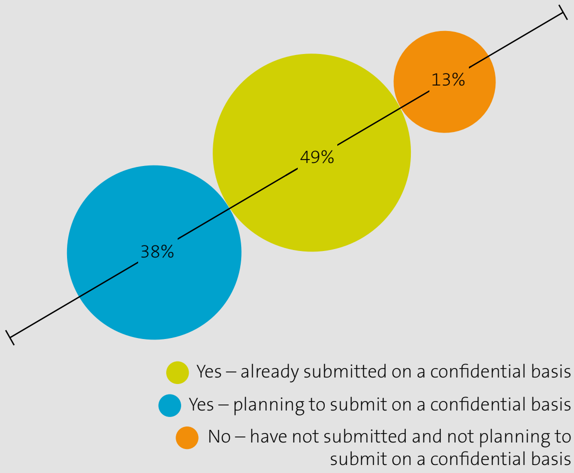


Figure 3.5: Have the other accommodations offered by the JOBS Act (such as less onerous disclosure requirements and testing the waters) influenced your decision to go public?

Listing in Asia

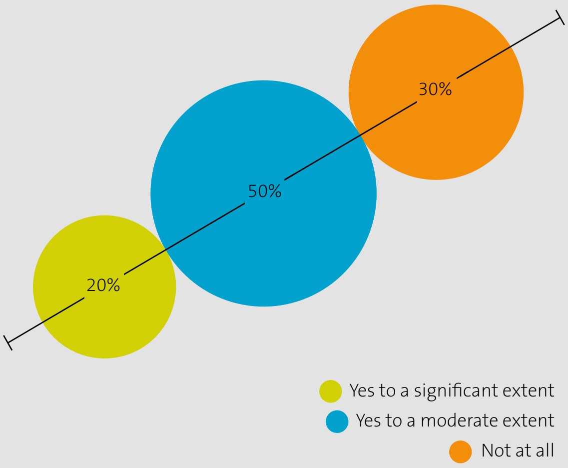
How has volatility in the Chinese equity markets affected IPOs?

The last year or so has seen a high degree of volatility in Chinese equity markets as the economy's growth trajectory moderates and the fear of an asset bubble periodically haunts investors. Last summer saw major falls in the markets as the Shanghai Stock Exchange experienced a drop of over a third in the space of a month, ushering in a period of turbulence that continues into today's markets.

The majority (70%) of respondents looking to list in Asia say that recent turmoil has influenced their decision, including 20% who say it has done so to a significant extent (see figure 3.6). The CFO of an Indian leisure company says that it has made them reassess their IPO: "We were due to carry this out last year, but once the Chinese market slumped, our market took a turn for the worse. This has directly affected our ability to get capital and has made us a bit sceptical."

Among the 30% who said it hasn't affected their strategy, most are seeking to list in other Asian markets, where volatility is more moderate. "The Chinese equity markets have not influenced us," says the Group Finance Director of an Australian leisure company. "We know our domestic markets well and this has helped us to plan the strategies for the IPO so we would incur minimal losses, if any occur."

Figure 3.6: Has the recent turmoil in Chinese equity markets influenced your IPO strategy?



Listing in the UK

How do respondents feel about proposed changes to the UK IPO process?

After a year-long study, the UK's Financial Conduct Authority (FCA) is now looking to reform the IPO process in a set of proposals to reduce the opportunity for banks to cross-sell services in addition to their advisory mandates for companies seeking access to the capital markets.

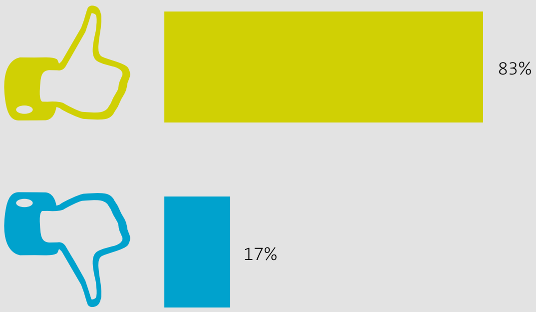
With the aim of improving the information available to investors in IPOs, the FCA is considering a change to rules that could promote research on issuer companies being undertaken by analysis not connected to underwriters.

All respondents seeking an IPO in the UK say they would welcome such a move. Changes to encourage earlier publication of interim prospectuses are also seen as beneficial, with 83% saying they are in favour (see figure 3.7).

Finally, three-quarters of respondents say they would be in favour of changes that would enable independent research analysts' access to issuers' management during the process.

There is also a high degree of support for moves that will increase and improve the independence of analysts' coverage of companies. "Increased analysis coverage is good for getting investors interested in the company," says the Head of Corporate Development for a UK healthcare company.

Figure 3.7: Are you in favour of changes to the IPO process to encourage publication of an interim prospectus by issuers at an early stage of the process?



Conclusion: staying afloat in stormy waters

Underperforming listings, the threat of rate rises, Brexit, the US elections and the China slowdown has ramped up the pressure on the IPO market. However, volatility is not unprecedented and, when the IPO window opens again, companies need to take the following steps to take advantage of the opportunities

1 Think like an investor

Consider what will make your company attractive to investors – and seek out good advice on this. Examine whether areas such as shareholder return policies are right for volatile times, for example, and try and view your company as an investor might: Is your capital structure right? Are you focused enough on generating sales? Could you implement operational improvements?

2 Consider the alternatives

Given that it is very difficult to accurately predict when an IPO window may open, companies need to explore other options to ensure they can still meet their strategic objectives. "If you're looking to raise cash for growth through an IPO and the market is closed, you need to be flexible," says Reed Smith's Aron Izower. "What other routes could you take to raise that capital in the interim, that would then allow you to list at a later date?"

3 Start early, stay late

Addressing accounting and auditing issues and getting the necessary financial statements prepared are steps that can take time and need focus. However, some other areas, such as tax planning and ensuring the right corporate governance structures are in place should not be overlooked as these can have long lead times.

4 Don't forget about business as usual

Make sure you have the right resources in place to keep the firm running effectively while preparing for IPO. "Don't prepare at the expense of running the business," says Reed Smith's Matt Gorman. "Both activities need to be undertaken at the same time – and having the right advisors to help with the preparation is a good way of ensuring resources are not stretched too thinly."

5 Get your story straight

"There will always be some element of market volatility, but strong companies suffer less from this than those that go public on the hope of future performance," says Reed Smith's Herbert Kozlov. "Those approaching the public markets should be doing so with a strategy that goes beyond quarter-to-quarter reporting. We counsel our clients to take a deep breath and look at what the company's total shareholder returns are on a multi-year, not a multi-month, basis."

6 Avoid surprises

Investors react to surprises at the best of times, but volatile market conditions can lead to over-reaction. "Make sure the company is ready from a governance and disclosure perspective before the IPO," says Kozlov. "Companies need to have already vetted their executive officers and directors, carefully analysed their historical financial performance and how that will be presented post-IPO, and learned what disclosure obligations they will have once they are public."

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