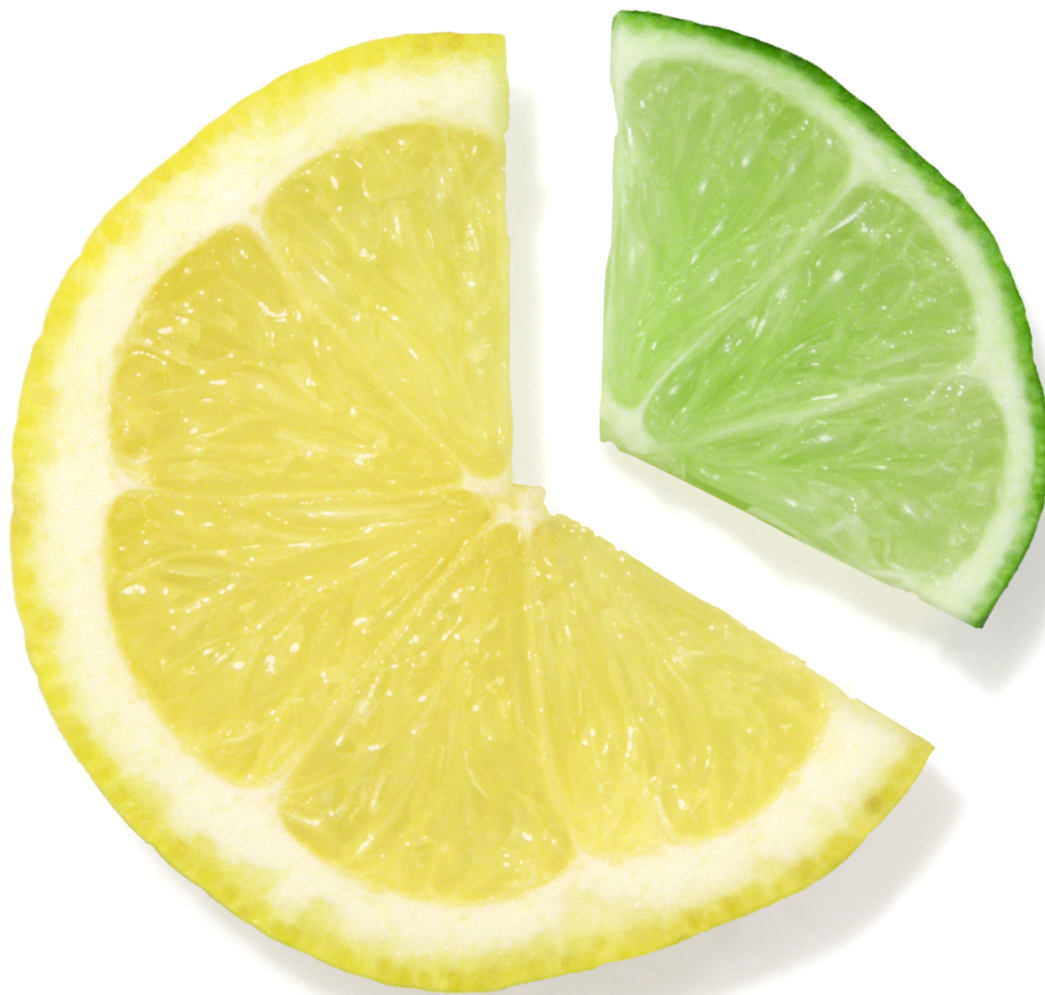


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**Getting ready to
go public: How PE
investors can help**

Introduction

As initial stock offerings get done at a rapid pace and with high valuations, the urgency around private companies being ready to go public is heightened. A skilled management team needs to be in place, financial systems need to be ready to scale, the company has to be able to accurately project future financial performance, and the corporate governance and professional support that public company requirements make so vital need to be activated. Private equity investors, who are participating more often in late-stage growth companies, can be a valuable resource in this public company preparedness effort.



The IPO window is open

The floodgates have opened for late-stage growth companies backed by venture capital (VC) to finally reach the public markets. Although the initial months of COVID-19 caused volatility and uncertainty in the markets, initial public offerings (IPOs) took off in the second half of 2020. The full-year tallies were remarkable: 102 traditional IPOs raised \$222 billion, and on top of that, 250 special-purpose acquisition companies (SPACs) raised \$75 billion.¹ The total value of VC exits reached a record \$290.1 billion, topping the record levels achieved in 2019.²

This surge in liquidity has helped provide greater validation around the growing involvement of private equity (PE) investors in later-stage growth equity. Expansion-stage companies that had stayed private for years and reached unprecedented valuations, enabled in part by PE investment, became the year's biggest IPOs. Airbnb, for example, after taking \$1 billion in debt and equity funding earlier in the year from PE investors, became the

biggest IPO of 2020, with a share sale in December that valued the company at \$47 billion.³ PE firms' growth equity investments reached \$62.5 billion in 2020, an all-time high, even as the overall value of PE dealmaking declined versus 2019.⁴

All of this bodes well for the VC industry in 2021 and suggests further convergence with PE funds. As exits put money back in limited partners' pockets and demonstrate the potential for strong returns, investment is likely to flow back into VC funds and the segments of the PE industry focused on growth companies. What's more, with markets having surged in the second half of 2020, supported by the Federal Reserve and fiscal stimulus, PE investors face a very competitive market for mature companies. This has prompted them to look elsewhere for attractive deals, especially in the technology sector, including the private market for later-stage VC-backed firms.

Being ready to be public

Against the backdrop of strong IPO activity, there is urgency for growth-oriented enterprises to be sure they are properly prepared to be public companies. The unprecedented number of SPACs shopping for deals—five times as many raised money last year than any prior year⁵—also increases the likelihood that public ownership could come sooner than expected and before an organization may be truly ready. SPACs have a limited shelf life (for most, a two-year clock ticking to get a deal done), and

additionally, VC and PE investors may be anxious to monetize quickly while the IPO window seems to be wide open, thus accelerating exits.

Deloitte sees five focus areas that will likely go a long way toward ensuring that a company is preparing adequately for public ownership. In each area, we highlight the ways in which PE investors and their representatives on the board can be a valuable resource.

1

Putting the right management team in place.

The idea people who founded a company and shepherded it through the early years may want to look for a CEO more experienced with managing and scaling a business and facing the scrutiny of bankers, regulators, and a broad investor base.

The CFO will also be key, taking on the responsibilities of public company financial reporting and also telling the company's story and defending its strategy. The person in this role needs to have the reputation and experience to talk to Wall Street. Depending on the company, there may be other C-suite roles that need to be filled out with experienced people as well, leading marketing, operations, talent, diversity, and technology.

While a company's VC backers will have brought in their own leadership along the way, a company preparing for public ownership will likely go through a bigger cultural shift than it has at any prior juncture. At this point, expanding the involvement of PE investors may be a big advantage, giving the organization access to a larger and more varied pool of executive talent. The board members representing PE investors can be especially valuable for their relationships and broad network of available and experienced executives.

2

Have the necessary systems to scale.

A young, innovative, and growing company may be working with software and systems that are homegrown or cobbled together. This is not necessarily a bad thing. The way systems have been designed and built for the business may represent the secret sauce of the enterprise. Sometimes a company's choices to do things differently are at the heart of the company's success. And yet, at the inflection point of public ownership, systems need to be reviewed to be sure they include proper controls, security, and functionality. Leadership needs to ask, for example, whether customer information is properly protected. Such things are about to become much more important, as a single breach has the potential to be catastrophic.

Some systems may need to be replaced. If a company has been working with small-business bookkeeping software, for example, it will be time to migrate to financial accounting systems that are appropriate for a larger public company. The platforms that worked for 5,000 customers may need to scale for 500,000 customers. The systems also need to be sufficiently robust to produce the timely and accurate financial reports that regulators and investors are going to demand.

PE involvement in the company may again be an advantage in meeting this goal, as a PE investor will be accustomed to funding such initiatives. PE firms typically take a longer-run view of the importance of robust, scalable systems. Failure to make the necessary investments in systems could negatively affect a company down the road—and PE investors may be sensitive to that.

3

Build the ability to project future financial performance.

When a company's earnings fall short of its projections for a quarter or two, it may take years for its reputation and stock price to recover. In other words, the importance of having a solid financial planning and analysis (FP&A) group and processes in place can hardly be overemphasized. This cuts to the heart of being prepared to be public—and is another area where the expertise of the PE representatives on the board may be valuable. PE investors assess firmwide investment decisions based on forecasts for their investments, and their having the ability to forecast is highly valued.

4

Establish proper governance.

Proper governance can't be ignored as companies ready themselves for public ownership. Leadership needs to ask whether the company has the appropriate number of directors and the necessary experience and diversity represented on the board so that it can successfully perform all of its required functions. California requires public companies headquartered in the state to have at least one female director, and many investors today rightfully expect greater diversity than that. PE firms are increasingly focused on environmental, social, and governance (ESG) criteria in selecting portfolio companies and may bring significant knowledge on this subject to the table.

A board also should have a good mix of experience. It may be helpful, for example, if some directors have an M&A background, deep knowledge of a specific industry, marketing expertise, or experience in succession planning and executive recruitment. The presence of both VC and PE representatives can help in creating this diversity of experience on the board. It's also necessary to have outside or independent directors, and it may be difficult to recruit for that role at present with so many companies newly public or headed that way.

5

Identify areas where you need to outsource.

Public companies need professional guidance and support in a number of areas. They certainly need it for accounting and compliance, but they may also benefit by outsourcing necessary systems upgrades or cybersecurity. Outside consultants can be appropriate to write technical accounting memos, develop internal controls, or help with close process review.

Young enterprises may stumble because they fail to look for help or because they fail to get it in place early enough. For some, trying to do everything in-house can be a bad habit, and investors will likely expect that outside and accountable players are supporting a company's internal team. Indeed, with entry into the public markets approaching, a company should do a thorough review and assessment of where outside support might be used, then get that support in place. In current market conditions, with exits happening in rapid fashion (as noted with SPACs above), time is often of the essence, and additional help may therefore be needed.

Conclusion

When an innovative startup has been shepherded by VC investors from early ideation to market success, putting it on the cusp of public ownership, it's tempting to see the company's story as written solely by the founders and the VC team. But think of the PE investors as an experienced editor or coauthor, bringing additional perspective to the tale. A late-stage PE investor can shape the business and give its board more depth and help the company to be a success story.

At a time when the IPO market is booming and SPACs are pushing companies quickly toward public ownership, it becomes vital to tap all available resources to help prepare. Bringing this entire team to the table—founders, VCs, and PE investors—will likely produce the best outcome, getting the company ready for a public market debut that goes smoothly and creates value for all involved.



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Endnotes

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