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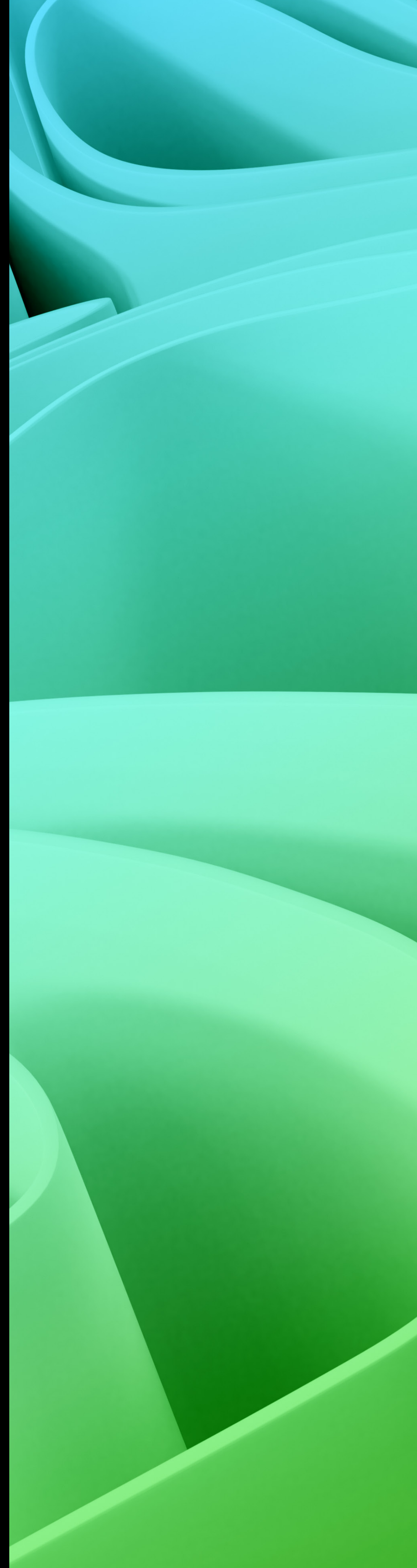
IPOs: When C-Suite hindsight is 20/20

Thinking about becoming a public company in the next 24 months? The time is now to start preparing.

The recent IPO surge proved to be an unprecedented period with over 800 U.S.-based companies going public since the start of 2020 either through a traditional IPO or a SPAC merger. These companies have ranged from those that put in significant time and resources to prepare over a 12- to 18-month (or longer) period to those that had only a handful of months to prepare and go public. The CEOs and CFOs we've talked to have shared common lessons that they believe are critical to the successes of transitioning to a public company; some of those include the following:

- Consistently developing and meeting internal forecasts
- Establishing and articulating key performance indicators (KPIs) and non-GAAP measures
- Clearly defining and delivering the company's growth story
- Building or having a plan to build a robust finance organization and investing in human capital to support the aggressive close, consolidate, and report demands
- Establishing a strong corporate governance framework, including ESG considerations



Setting the stage

The summer of 2020 ignited the start of a rush towards IPOs that lasted through the end of 2021, leading to the most historic time period for both IPOs and SPACs. In 2021, over 300 IPOs were completed, more than double the average from the past two decades, while nearly 200 SPAC mergers closed[1], multiples above the two-decade average. These statistics point to an unprecedented surge.

As we enter 2023, we've seen a different story unfold. We've seen these historic records significantly drop, with only about 100 transactions completed during 2022 through a traditional IPO and SPAC merger, respectively[1]. The current economic market is more volatile than the recent past, with drivers such as rising interest rates impacting how the market is trading. Many companies are delaying going public and shifting their focus to profitability and/or other sustainable growth measures. While there is uncertainty to when the next IPO window will open, we draw upon the experience of the CEOs and CFOs who went public during the surge to understand why the time to get ready to go public may be sooner than you might think.

Lessons learned since the last IPO window — Observations from the C-Suite

We obtained valuable insights from CEOs and CFOs to help prepare companies contemplating going public when the next window opens. A company's comprehensive readiness plan is key to performing well in the market, whether it is up or down. Below we address the key areas where many C-Suite executives faced challenges in being a public company; with hindsight they wished they had addressed these items earlier in the process.

1. Internal forecasting
2. KPIs and non-GAAP measures
3. Growth story
4. Finance infrastructure and human capital
5. Governance

1

Internal forecasting

Operating as a public company requires financial planning and analysis (FP&A) to be delivered more quickly than is typical in a private environment. While delivering forecasts on shorter timeframes is pivotal, missing projections can carry significant ramifications for companies. Executives cited the following as some of the key setbacks:

- Developing robust and detailed models
- Creating an accurate long-term plan for capital expenditures
- Aligning capital requirements with growth objectives in multiple environments
- Incorporating rising interest rates into their models

We recommend focusing on consistently developing and meeting internal forecasts for an average of 4-6 consecutive quarters to help prepare private companies for the expectations of a public company.

Looking back to the second quarter of 2021, a multitude of newly public companies missed analyst expectations which we saw lead to negative results. We can draw on these examples and point to the importance of accurate internal forecast and modeling. Not only were companies missing their earnings, but they also could not adequately explain to their analysts why the miss occurred. This resulted in a sharp decline in the share price for these companies along with a loss of investor confidence.

Lesson learned: Be prepared to adequately forecast and meet those forecasts; if there is a miss, be ready to carefully explain why. Carefully develop detailed models, create accurate plans, understand growth objectives, and understand the impact of current macroeconomic conditions on company operations.

2

KPIs and non-GAAP measures

Non-GAAP financial measures and metrics are commonly reported by both already-public companies and those seeking to go public given that they often provide meaningful and valuable insights into the information that management considers important to running their businesses.[2]

CFOs and CEOs have commonly faced challenges around the identification of non-GAAP financial measures and metrics that are most relevant to their industry, along with consistent reporting each period. Those companies that did not perform benchmarking studies (against their competitors to help determine relevant metrics to report on) until later in the IPO process were left scrambling with little time to accurately obtain historical data on those measures.

Additionally, we've seen many new registrants struggle with the quarterly reporting requirements for a public company, much less including the non-GAAP measures within. Many companies did not allow for adequate time to prepare the metrics and non-GAAP measures to be included in the quarterly financial statements, resulting in missed reporting deadlines and sometimes changes in the metrics being reported – all leading to additional scrutiny from analysts.

Some companies established KPIs and reported on them for the first time during the period in which they also went public. Additionally, during the reporting period some companies were modifying their KPIs to describe performance in a more positive way while also adding KPIs to explain the negative performance of the original KPI. This resulted in an inconsistent story, leading to questions from analysts and, in some cases, a loss of investor confidence.

Lesson learned: Take reasonable steps towards performing a comprehensive benchmarking study to determine relevant KPIs and non-GAAP measures and metrics to report upon; be ready with the frameworks in place to report upon during quarterly and annual reporting.

3 Growth story

A company's growth story is a key element to a company's brand and its executives need to be prepared to recognize what matters to investors. CFOs and CEOs need to be able to clearly communicate growth equity aspects including but not limited to:

- The company's growth and vision
- Plans to scale operations to improve performance metrics and meet quarterly and annual forecasts
- Market opportunity and competitive advantage against competitors
- The suite of products or services offered and the value in the current environment

Communicating a company's growth story and having effective discussions with analysts are critical components to gaining investor support. It became clear when companies did not leave enough time to plan for these considerations, and they found themselves scrambling as their public offering date got closer, a challenging time typically with many issues to square off.

Many companies experienced difficulty not only communicating who they are in terms of their business model, but how they plan to grow and effectively show results in line with their growth story. We observed several companies shift their stories as volatility in the market occurred or when their growth strategy could not be met, further eroding investor confidence. As a leading practice, management should consider performing 'dry-runs' to test their growth story against historical results and understand how they should best illustrate their growth strategy.

Lesson learned: Know your business, and how you will effectively operate in the current environment; thoughtfully prepare responses and practice early. Be ready to clearly articulate your growth story.

4

Finance infrastructure and human capital

One of the most critical keys to a successful IPO and beyond is having a finance team with the appropriate skill sets, as well as a finance infrastructure to meet the objectives and demands of a publicly traded company. Not only is the team important but having the proper processes and technologies in place are also hugely important.

The CFOs we talked to all expressed the "war on talent", a dire demand for finance and accounting professionals, and the competition in the labor market that continues to be scarce. CFOs indicated this impacted and continues to impact implementation of Enterprise Risk Planning (ERP) systems, preparation of technical accounting analyses, implementation of a robust control environment and the preparation and filing of SEC- and GAAP-compliant financial statements.

Scarcity of labor resources also resulted in an increase in the costs of building a winning team and executing the finance and operating infrastructure quickly. Some companies that waited to fill positions until after they went public found it challenging to source and obtain the right talent, which led to the need to pay a premium on salaries or engage in expensive recruiting. The message we heard consistently was that regardless of how hot the IPO market is, companies should spend the appropriate amount of time necessary to thoughtfully plan and execute their human capital strategy. Some CFOs suggest weighing the option of hiring internally versus finding an external advisor to meet their finance goals and objectives.

Lesson learned: Understand the infrastructure and operating model required to operate as a public company, along with the human capital necessary to sustain operations.

5

Governance

A key addition to the public company demands is around corporate governance. While many private entities have a board in place, we have seen many who do not have the board composition to meet exchange listing requirements (e.g., NYSE and NASDAQ). Further, the design and implementation of the various operating committees (audit, compensation, nomination/governance, disclosure/risk) does not commonly exist in a private company environment. One of the biggest challenges for companies that we observed was the amount of time and effort required to identify and recruit the right board members that fill critical governance needs and fit the culture of the company.

Proper governance and committee oversight has been paramount to the quality of financial statements produced by management and the control environment in place to support those financial statements. As companies were not well-prepared to go public, there was not an appropriate amount of time needed to stand up the necessary governance infrastructure and oversight to avoid some of these issues.

Lesson learned: Identify appropriate members to actively participate on the company's board and committees early; avoid waiting until you are almost public as the right resource may not be available.

Emerging considerations for going public

On top of the traditional areas companies must plan for during the IPO process, new entrants now also need to consider the pending regulations surrounding Enhancement and Standardization of Climate-Related (ESG) disclosures.

On March 21, 2022, the SEC issued a proposed rule to enhance and standardize climate-related disclosures provided by public companies. SEC Chair Gary Gensler emphasized in his statement expressing support for the proposal that "if adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions and would provide consistent and clear reporting obligations for issuers."

At this time, private companies are not subject to the proposed rule. However, private companies that plan to go public may be required to comply with the proposed rule. Private companies will need to consider the implications of the proposed rule on their business for the following reasons: (1) ESG equity story — many in the investment community want to understand your ESG journey prior to making an investment decision and (2) ESG governance and reporting — companies may need to comply with regulatory reporting requirements by the time they have their public offering and like other regulatory requirements, CFOs and CEOs want to be focused on their business operations and not implementing new processes and controls for reporting on items to their regulator.

Whether or not the proposed rule on ESG reporting requirements is approved, investors have shown repeatedly that they place value on a company's efforts related to ESG initiatives and reporting, including grounding the narrative in comprehensive data. Companies going public will need to have a well thought-out ESG strategy and also align it to their overall growth story.

While the rule is not yet finalized, companies considering an IPO should prepare early for the reporting and disclosure implications specific to their business and understand the impacts, which may pose significant data gathering and process-related efforts.

Conclusion

Many of the pitfalls identified by CEOs and CFOs of companies that went public during the recent surge can be addressed during the IPO readiness phase. Companies need adequate time to prepare for a public exit and to ensure they have the appropriate team and infrastructure, which are key components to a successful IPO. No one knows exactly when the next IPO window will open; however, one aspect is very clear: preparing to operate as a public company requires early action to be executed successfully.

Considering an IPO?[3]
Click here to learn more about Deloitte's IPO approach.

In 2021 Deloitte served:

16 of the top **25** IPOs

65% of IPOs more than **$1 billion** raised

63% of unicorn IPOs

51% of all IPOs

61% of software IPOs

Considering a SPAC?[3]
Click here to learn more about Deloitte's SPAC approach.

In 2021 Deloitte served:

63% of the top **30** SPAC deals

49% of **all unicorn** SPACs

Authors

Will Braeutigam
US Capital Markets Transactions Leader
Deloitte & Touche LLP
+1 832 360 8338
wbraeutigam@deloitte.com

Previn Waas
US IPO Services Leader
Deloitte & Touche LLP
+1 408 704 4083
pwaas@deloitte.com

Barrett Daniels
US IPO Services Co-Leader and West Region SPAC Leader
Deloitte & Touche LLP
+1 408 704 4176
badaniels@deloitte.com

Meggan Gibson
Accounting & Reporting Advisory Senior Manager
Deloitte & Touche LLP
+1 402 996 0862
megggibson@deloitte.com

Nick Francesco
Accounting & Reporting Advisory Senior Manager
Deloitte & Touche LLP
+1 516 918 7040
nfrancesco@deloitte.com

Endnotes

1. Source: NASDAQ, SEC.gov, Pitchbook.com, SPACResearch.com; all data is as of September 30, 2022
2. On the Radar: A Roadmap to Non-GAAP Financial Measures and Metrics | Deloitte US
3. Based on 129 unicorn SPAC deals (Source: 2022 SPAC Research)