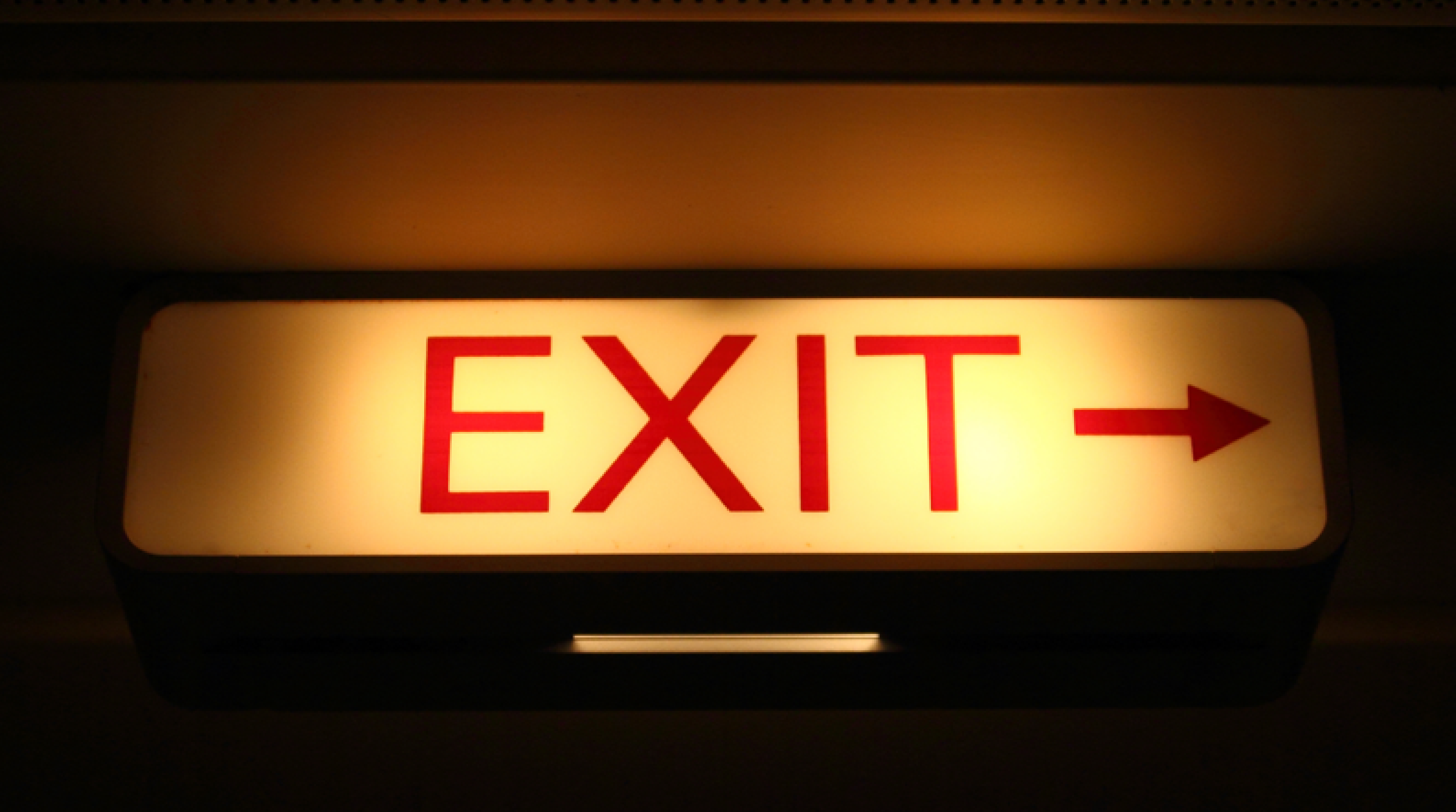
ROSERYAN | EXIT STRATEGY | WHITE PAPER




# EXIT STRATEGY PLAYBOOK:

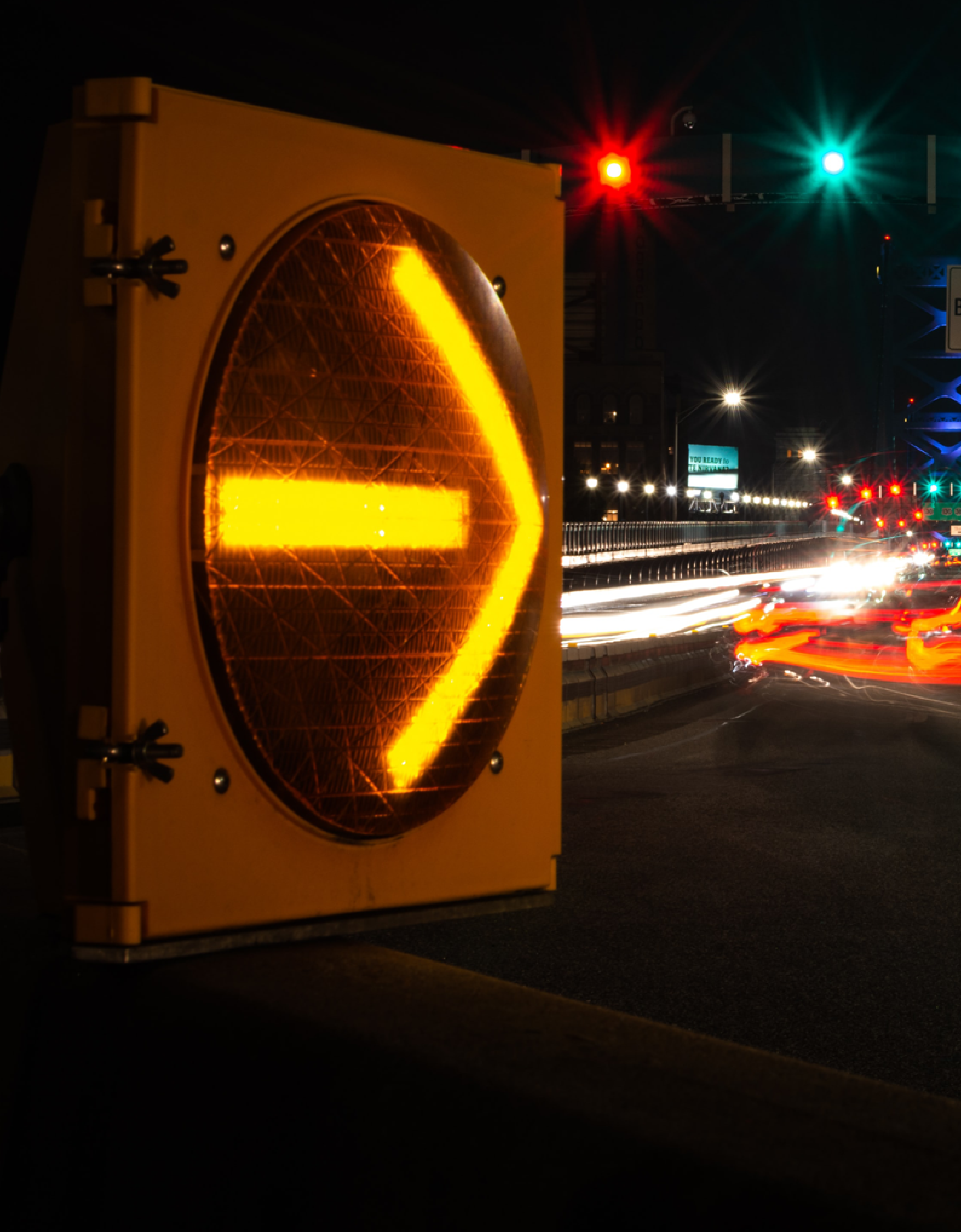
## Looking Attractive, Getting Ready for Scrutiny, and Making the Transition as a Public Company

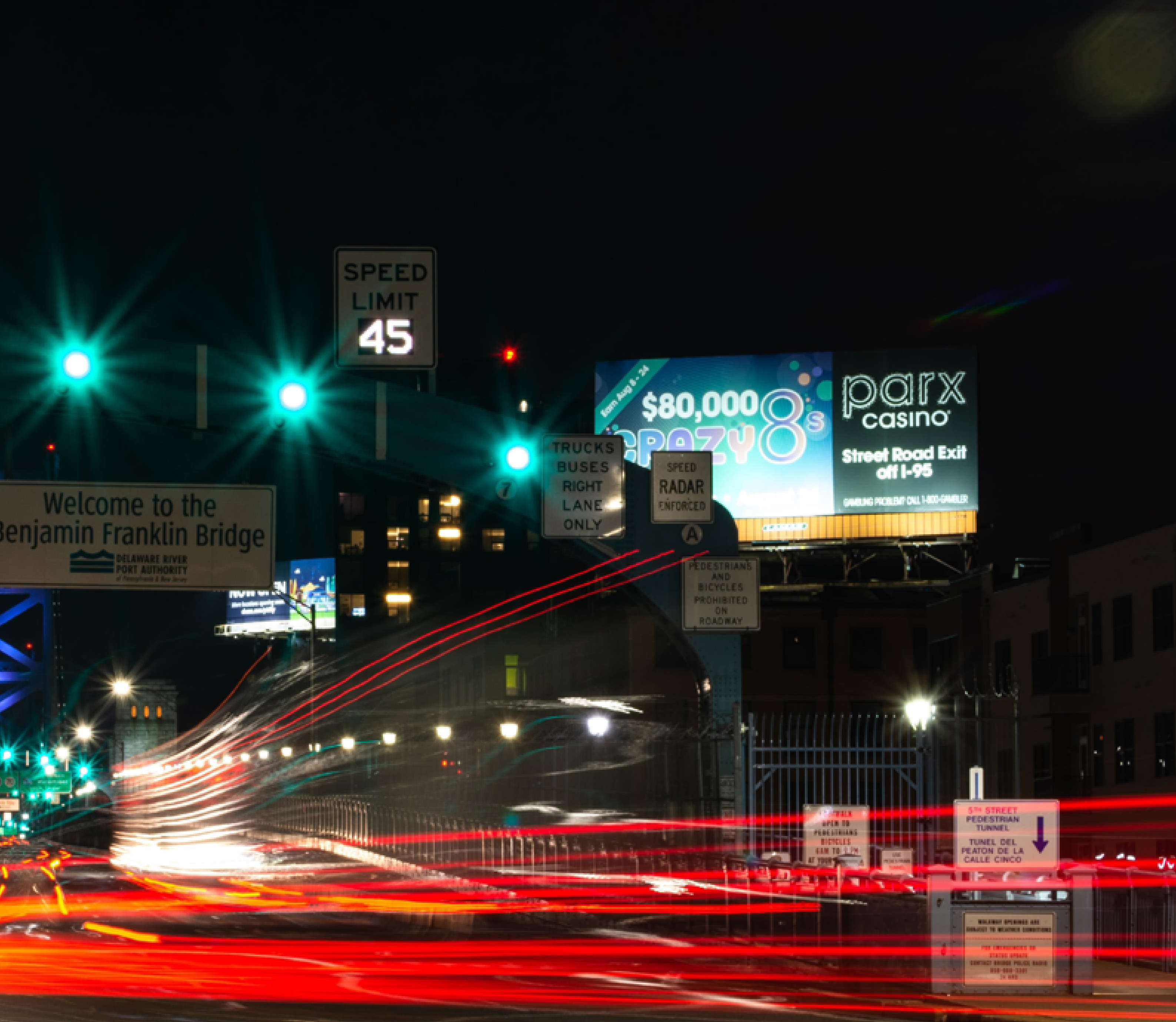
---

**WHAT'S YOUR EXIT STRATEGY, AND WILL YOU BE READY?:**

A guide for common exit strategies—IPO, SPAC, M&A—and preparing your company for the many changes ahead

**By Pat Voll**
RoseRyan Vice President




SPEED LIMIT 45
Welcome to the Benjamin Franklin Bridge
DELAWARE RIVER PORT AUTHORITY
TRUCKS BUSES RIGHT LANE ONLY
SPEED RADAR ENFORCED
$80,000
parx casino
Street Road Exit off I-95
PEDESTRIANS AND BICYCLES PROHIBITED ON ROADWAY
5TH STREET PEDESTRIAN TUNNEL
TUNEL DEL PEATON DE LA CALLE CINCO

# CONTENTS

# INTRODUCTION

As with most things in life, you always want to be prepared. When considering exit strategies, however, companies have to be ready to change routes if a better or more fitting offer comes along. Fortunately, some of the most popular exit strategies today—M&A, traditional IPO, or SPAC—have more in common than not in terms of making a company attractive to investors, anticipating the added scrutiny, and coping with post-deal impacts.

## M&A

**The upside:** A larger company could want access to your market, customers and technology. This exit could result in higher valuation over others because the buyer has an immediate need for your product or service.

**The downside:** Buyers typically eliminate acquired leadership teams and integrate the business into the parent company. In other words, someone else will call the shots going forward.

## IPO

**The upside:** Going public has many advantages—namely, the money raised can be transformative from a growth standpoint, and open up capital for funding R&D, hiring, building out facilities, and acquiring new technology or even other businesses. Your team gets to stay in place, and the company continues to operate. Also, the company can gain exposure to potential customers as it earns attention from securities analysts.

**The downside:** The IPO process is expensive, and the ongoing compliance costs of being a public company are substantial. Plus, your business operations and financial information will become public—your customers and competitors, as well as your investors, will know everything.

## SPAC

**The upside:** A special purpose acquisition company (SPAC) or "blank check" company provides a potentially easier and faster vehicle toward becoming a public company. Looking to merge with a target company, investor-sponsored SPACs are under a deadline (usually two years) to make a deal or liquidate. This way of becoming a public company opens up flexibility in structuring the deal to potentially include earnouts, escrows and other methods of allocating risks and upsides.

**The downside:** This speedy route to going public can be too much if a company isn't "IPO ready." The SPAC will need to include the target company's audited financial statements in its SEC filings. The clock for being SOX-compliant starts when the SPAC is funded—not when the operating company is acquired—so your ramp to full compliance with the Sarbanes-Oxley Act may be substantially shorter.

# BECOMING AN **ATTRACTIVE** INVESTMENT

Regardless of how you plan to exit, you'll want to look attractive to investors. As they seek out companies with strong business foundations and competitive advantages, they're focused on these areas:

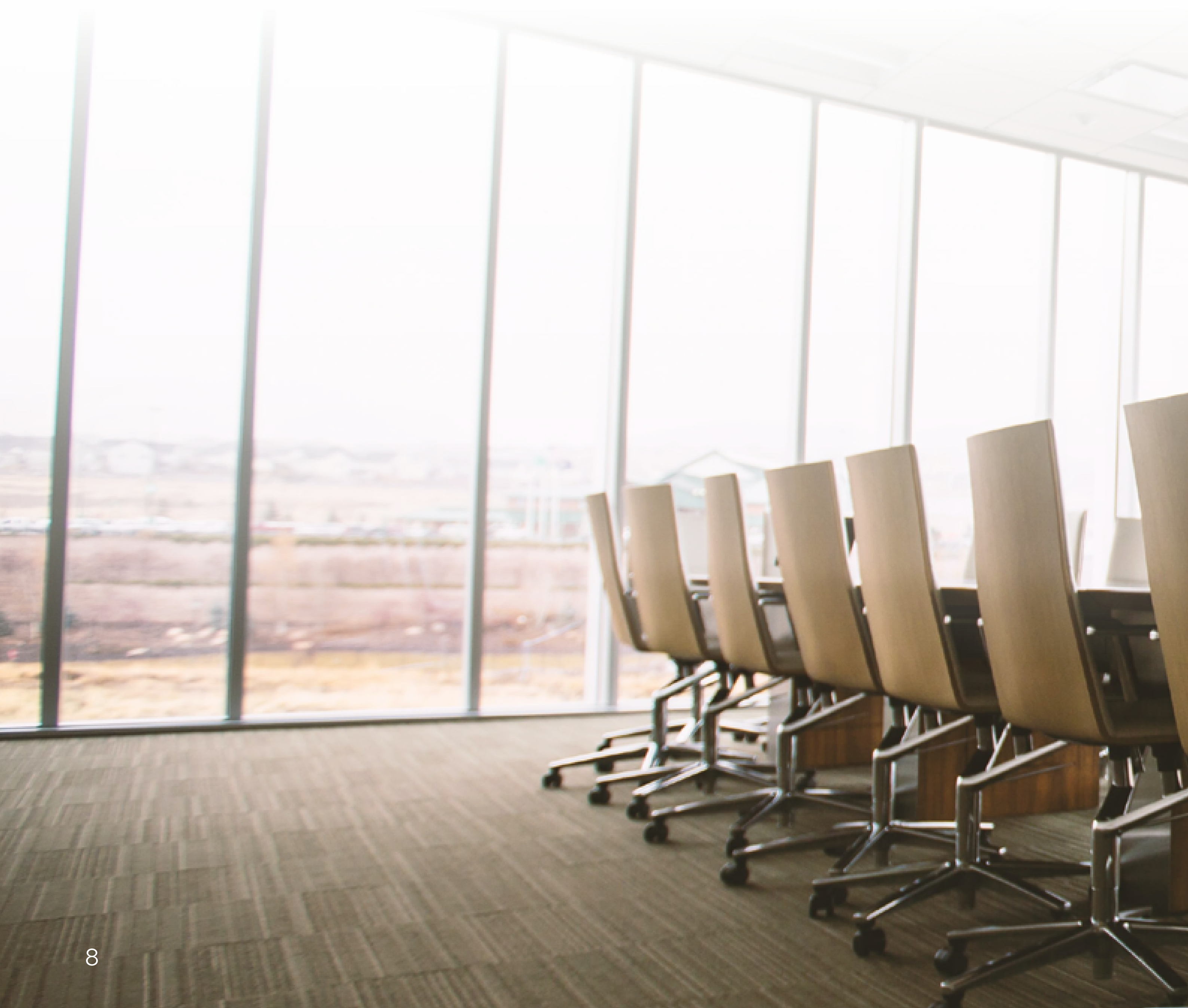
**Market potential.** What's your industry's addressable market size, and does it have strong growth potential? Your valuation is at stake, depending on whether you're in a declining market or a booming one. How much of the market are you likely to capture over time? What are your product differentiators? Is it innovative and unique, with high barriers to entry? Or is it going to quickly become a commodity as other players enter? How scalable is your offering? Do you have strong brand recognition—will customers pay a premium for your product, or are you competing on price?

**Talent.** Do you have a demonstrated ability to attract great employees? What's unique about your culture that enables you to retain your workforce in a competitive environment? Does your management team work well together? Is there high trust and collaboration?

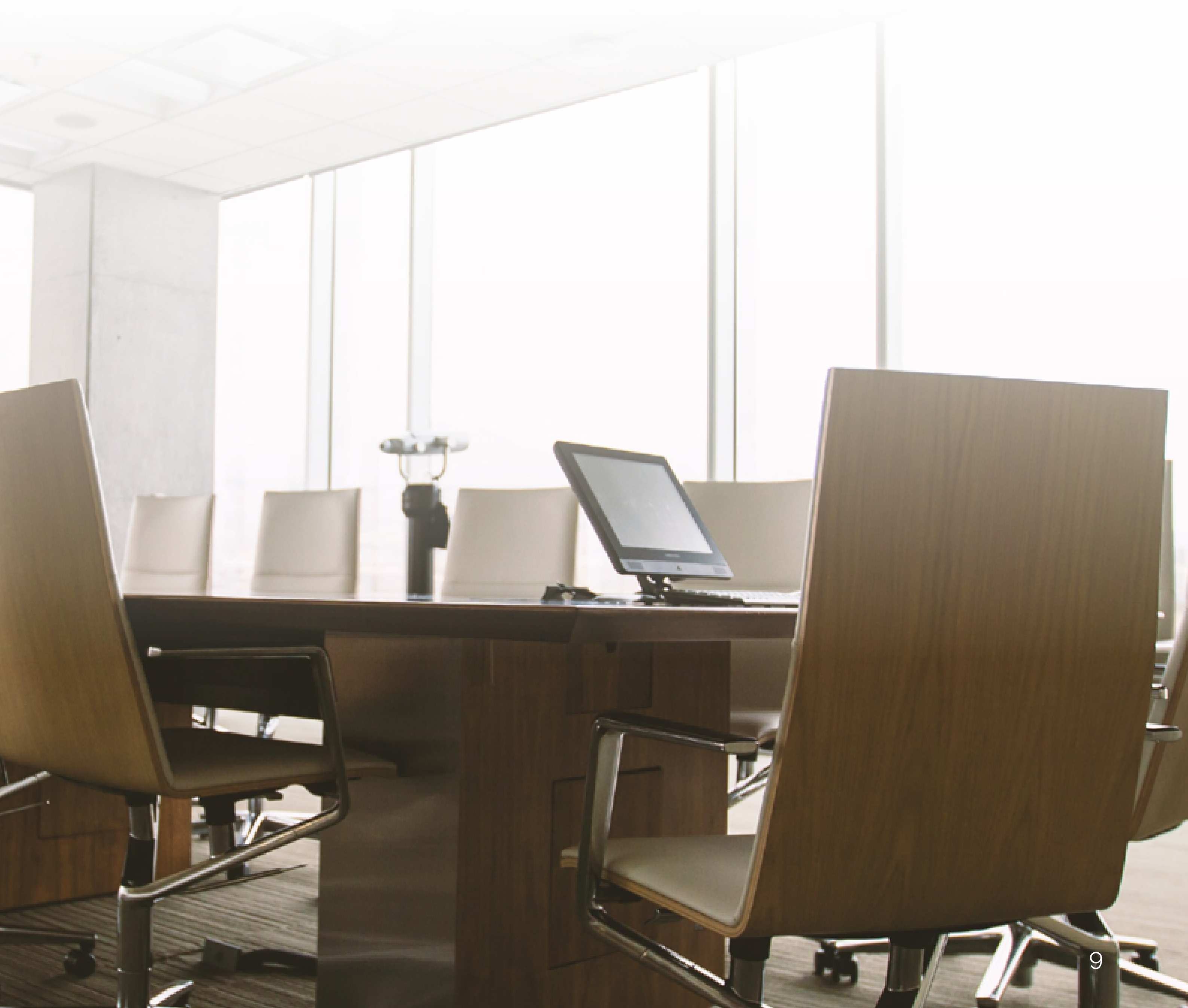
**Earnings quality.** Predictability of earnings potential is a plus—nobody likes surprises. Having a strong history of being able to forecast, and achieve, financial results is critically important. Are your revenue increases and profitability coming from your core business, or are one-offs masking trends? As you clean up your financials to be in compliance with GAAP, are the new figures telling a different story than you've been reporting (e.g., consecutive growth hasn't been happening)? You are better off getting at reliable, consistent results before investors start digging.

**Strength of the executive management team and board of directors.** Investors want to understand the experience and credibility of the executive management team—how committed are they to the organization? What is their experience in running a company, especially a public company—can they meet the demands and pressures of operating in a public arena?

As for the board composition, public companies have requirements about independence from management (the majority of the board must be independent, and the audit committee must be entirely independent). Does the board have deep operational and industry experience to provide oversight and guidance to the organization?



**Finance team capability.** Is the team ready to work at a public company, and is it adequately staffed? Can the team meet the rigors of SEC compliance? Are the systems and processes capable of supporting timely and accurate financial reporting, as well as scaling to support the growth of the business? In a 2020 study of material weaknesses in IPOs, KPMG found the leading cause over the past three years had to do with a lack of accounting resources and expertise, significantly more so than any other factors leading to a material weakness.



# PREPARING FOR **THE EXIT**

> Nobody wants to be at fault for a delayed or failed transaction, or a diminished valuation. Here are a few tips based on our experience helping clients through exits.

**Speak in your investors' language.** Entrepreneurs tend to be passionate about their product, but they do not always excel at expressing why their company would be a great business to invest in. (Hint: It's not all about the product.) Learning to speak the language of investors is an art—get coaching here—the sooner you start, the better off you'll be.

In the many places you'll be telling your story (e.g., your website, press releases, investor presentations), the message must be consistent. Before the diligence process kicks off, spend time verifying whether something needs to be updated—you can bet inconsistencies will come up later on if you don't.

**Be ready for the auditors.** We find companies that have not undergone an audit often grossly underestimate the amount of work to be done, set unrealistic expectations on the timeframe involved, lack the expertise to manage the audit process, or do not understand what their external auditors require. It's a steep and painful learning curve, and you don't want to be in the middle of a major transaction when you tackle this hurdle.
(See our paper "A Better Audit Experience: Setting Up for a Smoother Process.")

**Here's a partial list of common areas that lead to messy audit experiences:**

- Accounting records not prepared in accordance with U.S. GAAP
- Journal entries lack supporting documentation
- Significant complex transactions are not supported by a technical accounting memo, and may not have been properly recorded
- Revenue is not properly recorded
- Equity records are not reconciled and stock-based compensation is not correctly calculated
- Accounting policies are not documented, resulting in inconsistent accounting for similar transactions

**Perform a systems assessment.** Do your existing systems support your current business operations, and can they scale with your business growth for the next several years? The last thing anyone needs in the middle of an IPO is a new system implementation—that's a recipe for disaster and adds unnecessary stress, distraction and risk to an already stressful time. Conduct an honest review—does your system have adequate internal controls? Are your processes automated, or do you have a lot of side spreadsheets tracking your activity—that's a telltale sign your systems aren't up to the task.

**Take a hard look at your accounting and finance team.** The skillsets required to operate effectively in a private company are different than what is needed for a public company—what got you this far might not be what you need to go farther.

We're not just talking about preparing SEC reports. Public companies are subject to a lot more scrutiny—you'll need to be able to close your books on a timely and accurate basis, in accordance with GAAP, on a consistent basis, regardless of what else is going on in the business. You will have external auditors visiting each quarter—and with that comes their PBC (prepared by client) list, and a seemingly endless array of questions and additional requests.

So, you need bench strength. Do you have senior people who have public company experience and can guide the rest of the team through the rigors required? Do you have enough people to meet these demands? If the answer is no, now is a great time to outline the additional resources you will need, and figure out your recruitment process.

> "The skillsets required to operate effectively in a private company are different than what is needed for a public company."

**Evaluate your forecasting capabilities.** Throughout the diligence process your company's historical budgets and forecasts will be compared to actual results, and once it's public, research analysts will be closely scrutinizing performance against their expectations. If you miss expectations, you can expect your stock price to take significant hit. So now is a great time to develop the forecasting muscle—working cross-functionally to develop budget/forecast information and organizational discipline to meet those goals. Document significant variances as they occur, and refine your processes and hone your forecasting accuracy.

**Set up a "data room."** During the diligence process, you will have multiple parties asking for the same information. It's best to get a start on those requests, and put the information in a secure location where you can grant access on a need-to-know basis.
What kinds of information should you include? Here's a list to get you started:

- **Corporate documents**
  - » Articles of incorporation
  - » Bylaws
  - » List of subsidiaries
  - » Board of director meeting minutes
  - » List of jurisdictions where the company is authorized to do business, owns or leases property, or does business
  - » List of current officers and directors
- **Capital stock**
  - » Shareholder, option holder, warrant holder list
  - » Stock purchase agreements
  - » Voting agreements
  - » Cap table
  - » Stockholder agreements
  - » Stock certificates
  - » Registration rights agreements
- **Financial records**
  - » Audited financial statements
  - » Unaudited financial statements
  - » Quarterly financial statements
  - » Forecasts—projections and assumptions

  - Federal, state and foreign tax returns
  - Loan agreements
  - Lease agreements
  - 409A valuations
  - Accounts receivable aging
  - Accounts payable aging
  - Fixed asset schedules
- **Intellectual property**
  - List of patents and patent applications
  - Employee nondisclosure and proprietary invention assignment agreement
  - IP litigation summary
  - Trademarks and service marks
- **Material agreements**
  - Summary of material agreements
  - Summary of material agreements requiring consent in the event of change in control
  - Material sales agreements
  - Intellectual property agreements
  - Partnership agreements
  - Joint venture agreements
  - Noncompete agreements
  - Intercompany agreements

- **Insurance agreements**
    - Summary of all insurance policies
    - Copy of directors and officers insurance policies
    - Copy of liability insurance policies
    - Insurance claims pending
- **Employment**
    - Listing of all employees by title, salary, commission, bonus, date of hire
    - Org chart
    - Employee agreements
    - Health care plans
    - Employee handbook
    - Collective bargaining agreements
    - Bonus plans
    - Profit sharing plans
    - Commissions plans

**Get ready for SOX.** SOX becomes a way of life for public companies.
You don't have to be SOX compliant at this stage, but you should be SOX ready.

That means being able to provide documentation of your internal controls over financial reporting for your as-is state during the diligence process.
That's typically narratives, but could also be your risk and control matrix and even some limited testing. Potential investors want to understand your control environment, and gaps in your existing controls, as well as your plans to remediate them.

After all, SOX was designed to prevent material misstatements in your financial statements—and having appropriate controls in place adds credibility to your financial reporting.

# TAKING THE IPO EXIT: WHAT TO KNOW

Unlike an M&A deal or SPAC, which heavily involve another company, forming an IPO strategy keeps your company in the driver's seat. Here are some of the critical steps involved:

**1. Assemble the team.**

- **Employees:** A number of employees will be devoting significant time to this process, including the CEO, CFO, controller, in-house legal counsel and other key executives who can provide information about customers, products and important aspects of the business. Consider bringing in additional resources to keep everything running smoothly.
- **Attorney:** Companies often turn to an outside security attorney to draft the registration document (or acquisition document) and quarterback the entire process.
- **Investment bankers or underwriters:** A critical part of drafting the registration statement, they manage and market the IPO. They coordinate and help you prepare for the roadshow, and put together a syndicate to underwrite and sell your shares in the IPO and provide aftermarket support for your stock.
- **Auditor:** The auditor's work provides assurance that your financial statements and disclosures are appropriate, including the comfort letter information sent to your attorneys and underwriter's attorneys for items disclosed in the registration statement.
- **Other advisors:** Accounting and finance consulting firms can be essential assets throughout the process, as they provide expert advice and fill in the gaps on your team, depending on how much expertise your controller and CFO have with IPOs, and how much capacity they have to handle the work. You'll need someone who can draft all the financial sections for your S-1/F-1 registration statement in compliance with U.S. GAAP and SEC requirements, review the entire document for consistency, address audit issues, and assist with the SEC comment letter process.

**2. Draft the registration statement.** Typically your attorneys will take the lead on this time-intensive process, but all members of the team need to be involved. The registration statement has to achieve multiple goals—(1) meet the SEC's expectations by providing very specific information; (2) present your business in the most positive light; and (3) disclose the risks involved in investing in your company. It's important to develop a timeline for getting the draft together and making sure everyone involved sticks to it. Any delays in getting the draft out the door can derail your IPO timeframe.

The SEC has 30 days to respond to this initial draft—and then a back-and-forth process lasting multiple weeks could occur. A carefully prepared registration statement will minimize the amount of comments, but you should still expect some questions. You'll have to address all of the questions in writing, and you may need to revise the registration statement. Then, the SEC may come back with more questions, and you'll need to respond to those, and so on. Keep in mind all this correspondence will be made public after your filing goes into effect. And, you'll have to keep refreshing the financial information in the registration statement—it must always be current.

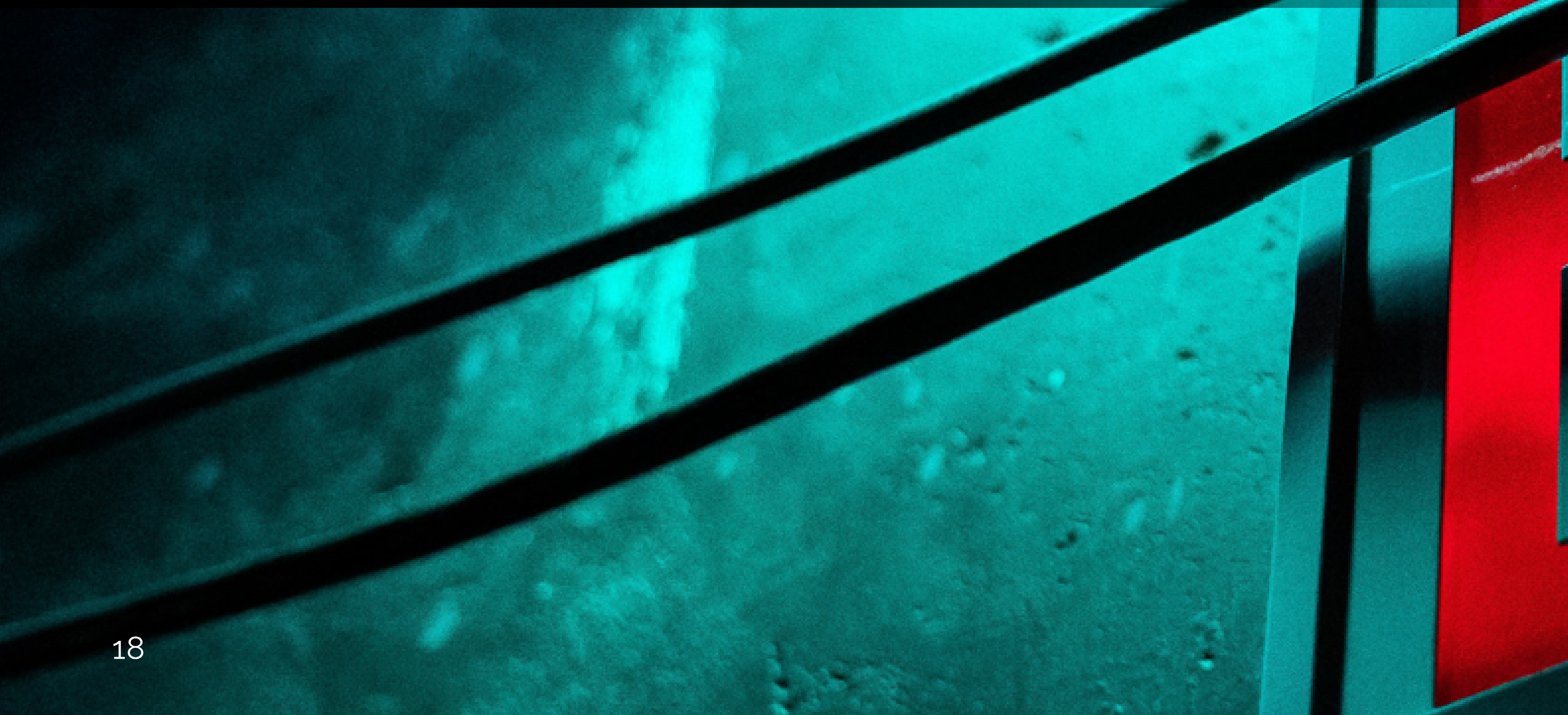
**Prepare for the due diligence.** The attorneys, bankers and underwriters attorneys will be reviewing significant agreements and other documents (collected in your data room), as well as conducting interviews with management, touring the facilities, distributing and reviewing questionnaires sent to the company's directors and officers, and conducting analysis on the company and its industry.

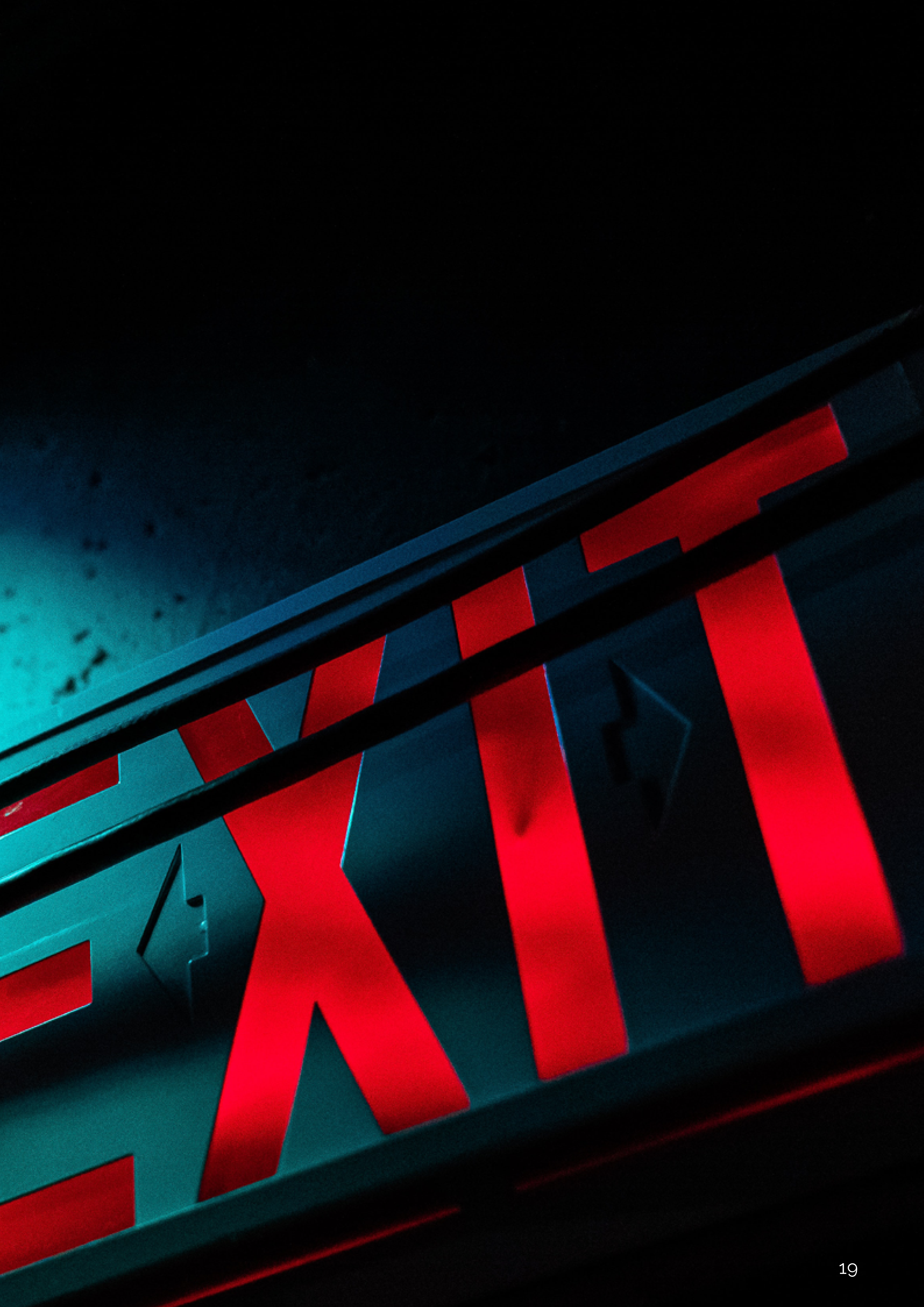
**Pack for the roadshow.** Here's where you get to tell your story to analysts, brokers and potential institutional investors. Arranged by the underwriters, these meetings take place at various locations throughout the country and internationally, and typically feature the CEO and CFO. It's a strenuous time, typically involving multiple presentations per day crammed into a two-week period, but it's a key selling activity. Everyone must be prepared to answer tough questions.

Then, finally, everything aligns—the underwriters and management come to an agreement on pricing, the SEC has no further comments, you can finalize and file the registration statement, and the offering can be declared effective.

# TRADITIONAL IPO VS. SPAC

For an acquisition by a SPAC, you won't need to go through everything listed above, because the SPAC is already a public entity—however, the acquisition of the operating company will require a proxy statement for shareholder approval of the merger, including pro forma financial statements filed with the SEC. You can expect a robust due diligence process, and a lot of the same information required in the registration statement for an IPO will be required for the SPAC's 8-K filing. Any acquisition may or may not require an SEC filing, but the due diligence process can be just as extensive.



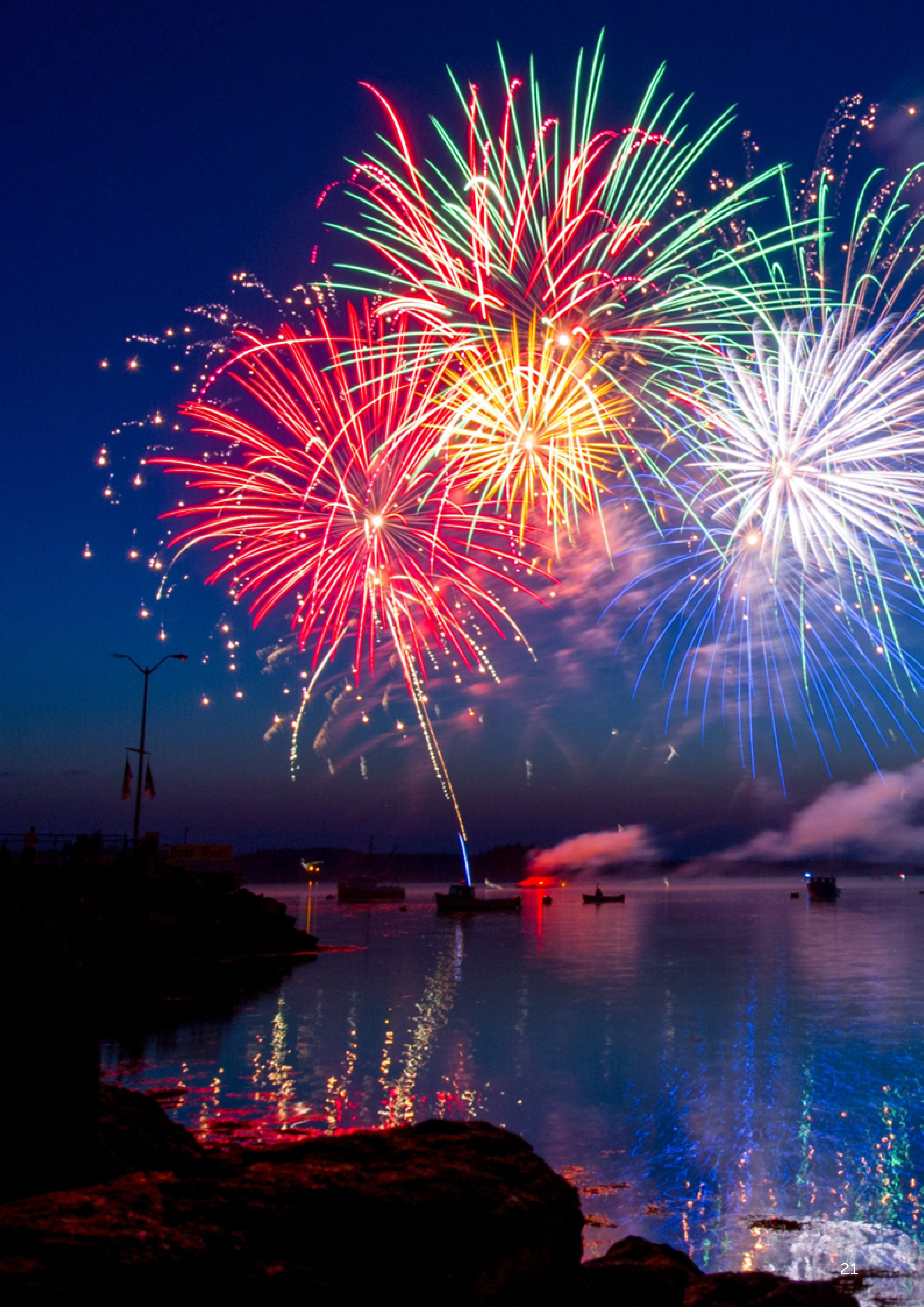


# DEALING WITH THE AFTERMATH

Congratulations—you have successfully exited. After the frenzy getting here, you are probably really looking forward to a big celebration and relaxing now that the pressure is finally off.

By all means, celebrate your success, but not for long—because life as you know it will never be the same.

You now have new ownership with different expectations, and new reporting requirements.



**Culture change.** Until this point, this area may have been overlooked, but significant changes to your culture are coming—and will be felt immediately. Both newly acquired companies and IPO companies face intense demands to not only meet but beat expectations. Do you have the culture in place to support your scaling business—or are adjustments in order?

Transitioning from an entrepreneurial culture to a more disciplined organization often results in clashes in philosophies—this is an area where you'll need solid leadership to get in front of the necessary changes and guide your organization through it. Think about the key elements of your culture that you want to hang on to, and how to incorporate that into the disciplined process you're now under.

**Enhanced accountability.** With new transparency of your financial and business results, there's a new kind of accountability you haven't experienced before. For example, your employees could have trouble digesting some of the information disclosed in your filing statements about executive compensation and other matters previously held in confidence. On the other hand, some of your key employees may find they now have significant wealth as a result of the IPO—and you'll need to think about retention.

**Constant wheel of information.** To meet SEC compliance rules, the accounting and finance team will have to close the books quickly (and accurately) and invite the external auditors for a quarterly visit. This means added work. A lot of added work. Your close process should include drafting complete financial statements with footnote disclosures and discussion of operating results and liquidity. You need to bake in time for review by your disclosure committee and board of directors (or at least your audit committee). And keep working closely with your investor relations team to prepare your earnings call script and a list of likely questions from investors (along with answers).

This is a coordinated dance, and it takes time to get the rhythm down. This might be an area where bringing in additional support to help your team acclimate to the demand for additional information and tighter deadlines makes all the difference.

**Sarbanes-Oxley compliance.** While there are a lot of requirements with SOX, Section 404—internal controls over financial reporting—is a top focus as public company management is tasked with designing appropriate controls and testing their effectiveness. And then they need to report this to their shareholders. This is an area where your auditors will also be taking a close look (there are exemptions from auditor attestation for some companies, but even in those circumstances, auditors need an understanding of the internal controls over financial reporting). For a newly public company, you will need to be compliant with your second form 10-K; if you were acquired by a SPAC, your SOX compliance timeline depends on the SPAC's IPO effective date, not when it acquired you.

> “It's a heavy lift to be SOX compliant, and our best advice here is to get started as early as possible—well before you head into the IPO process.”

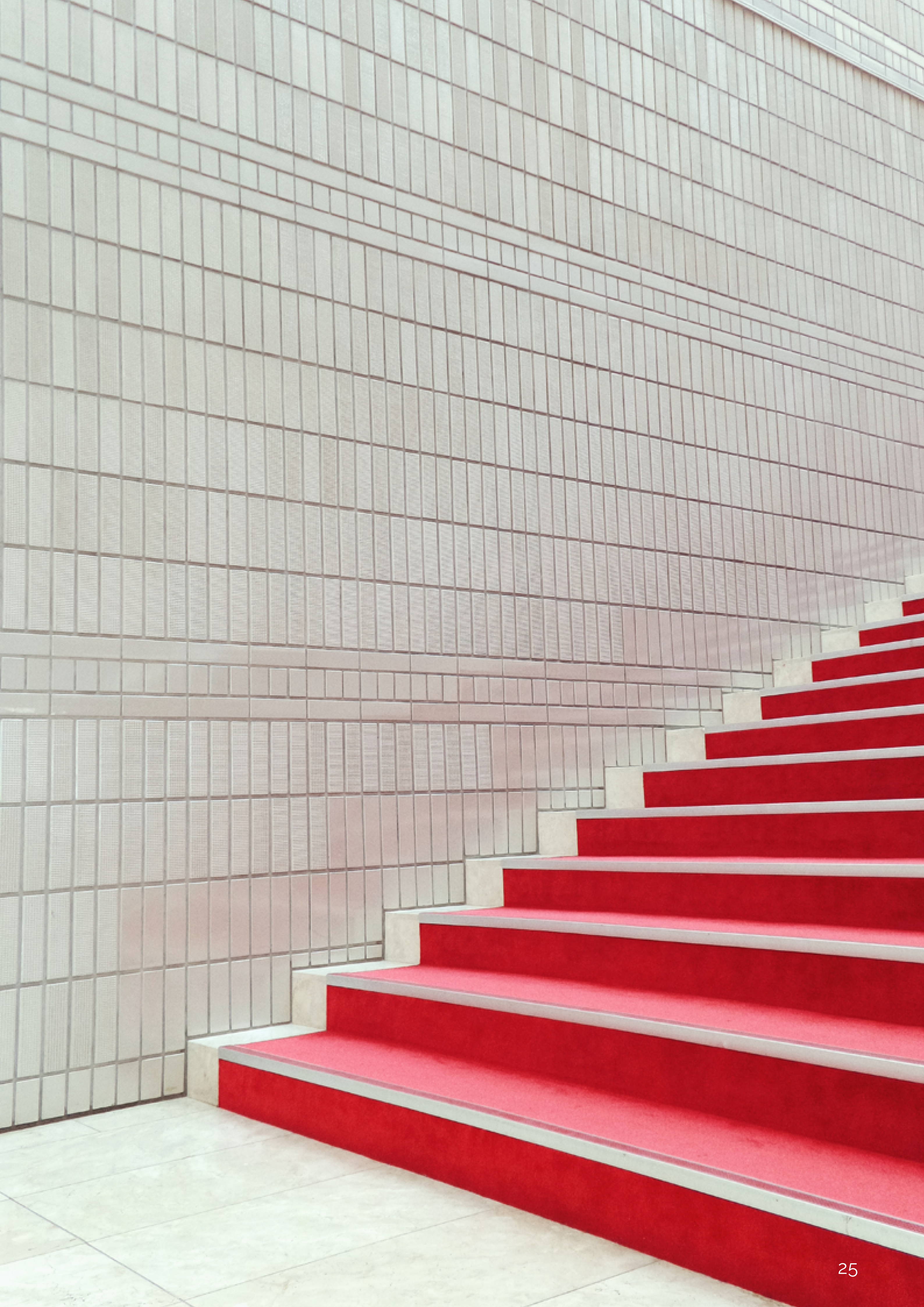
**Managing the stock price.** You need to live up to the story you told in your prospectus, on your roadshow, on your website, and in your press releases. Develop an equity storyboard to let your investors know how you are managing the business and increasing its value over what your competitors are doing. How you describe your talent, your product roadmap, your sales distribution channels and geographic expansion can have a significant impact on your stock price.

## ADJUSTING TO AN ACQUISITION

**Acquisitions have their own set of adjustments—folding into your new parent company's expectations and information requirements will be an adjustment. Are your systems set up to capture and report in the way they new owner is asking for? There are a lot of unknowns here, because the information requests can vary greatly. Our best advice—connect early to find out what expectations there are, and bring in help to assist your team in meeting the close requirements and on-going data requests**

# READY FOR ANYTHING

Thinking of your exit as a three-step process will help you weather the storm. None of this is easy and bringing in experts to support you in your journey will set you up for success. This may all be new for you, but for RoseRyan, it's what we do. Lean on us to guide you through the process.



# PAT VOLL

**Pat Voll is a vice president at RoseRyan,** where she provides strategic guidance into several practice areas, including corporate governance, strategic projects and operational accounting. She also manages multiple client relationships, develops new solutions for the firm and oversees strategic and corporate culture programs. **Pat previously held senior finance level positions at public companies and worked as an auditor with a Big 4 firm.**

**TAILORED FINANCIAL ADVISORY EXPERTISE** OUT OF SILICON VALLEY TO SOLVE EVOLVING COMPANIES' FINANCE AND ACCOUNTING CHALLENGES.

**Award-winning** RoseRyan's highly qualified, experienced finance and accounting professionals integrate seamlessly with your team to bridge the gaps and unlock the potential in your business.
We offer personalized, innovative outsourced, on-demand and full-stack solutions, services and scalable support at every stage of your company's life cycle: **from start-up to Fortune 500.**

**HOW CAN WE GUIDE YOU** TO TRANSFORM YOUR ORGANIZATION'S PERFORMANCE AND ACCELERATE YOUR PROGRESS **TOWARDS SUCCESS?**

**FIND OUT AT**
roseryan.com

sales@roseryan.com
510.456.3056 x 400