

Dual-Track Process

Considerations in Managing a Joint IPO and Sale Exit

What is a Dual-Track Process?

The “dual-track process,” broadly defined, means that a company planning on an exit transaction has chosen to go down the path of conducting an initial public offering while also pursuing a possible M&A exit. Traditionally favored by private equity firms with respect to their portfolio companies, the dual-track process has also gained currency as a possible exit strategy amongst fast-growing, venture-backed technology companies. The M&A side of the dual track process is most typically structured as a full-blown auction involving multiple strategic and financial bidders (rather than a direct one-on-one negotiation with a single bidder). However, there can be many variations within the dual-track framework, and careful consideration should be given to process before kick-off.

If managed and executed successfully, a dual-track process may offer a company seeking to exit the best prospects for actually completing such an exit, and potentially at a higher valuation than if either alternative was pursued in isolation. This is particularly the case in times of capital market volatility, as there is no guarantee that a target company will come to the market at the right time. While traditionally the M&A sale process has been seen as a back stop in case an IPO process is not successful, that perception is fading as emerging growth companies stay private for longer, and an IPO may not necessarily deliver an increased valuation. Moreover, as the dual processes are run in tandem, the target company retains the flexibility to opt for one path versus the other until late in the process.

However, a dual-track process is, in fact, quite difficult for many leanly-staffed technology companies to execute well. It can tax the limited

resources of the team tasked to run both processes while also keeping the company functioning. Therefore, caution should be exercised and appropriate resources devoted to the process.

Key Events in the Dual-Track Process

As noted above, a dual-track process will inevitably need to vary to fit the needs of the target company. In some cases, for example, the private equity or venture capital investors in a target company may prefer the full exit promised by an M&A deal, rather than the partial or gradual exit offered by an IPO and subsequent offerings that are likely to take place over a period of years. On the other hand, a company that believes it has significant long-term prospects may prefer an IPO, with the M&A path as a back stop in case the markets aren’t receptive or some strategic acquirer is willing to pay a significant premium. And sometimes board members and management have different views about the preferred outcome. With the dual-track process, it is a way to better understand the company’s real prospects under either scenario.

If an M&A deal is the preferred approach, the auction sale process may be the lead driver in the dual-track process, with the IPO taking a secondary role as a backstop and possibly a forcing function to keep pressure on the possible buyer or buyers. In some cases, however, the target company may focus on the IPO path, forgo a formal auction sale, and instead focus on one or two motivated acquirers with whom previous discussions have been held to see if there is sufficient interest to make it worthwhile to abandon the IPO process. In short, there is no “one size fits all” formula that governs a dual-track exit process.

However, as a general rule, every dual-track process will begin with the selection of both M&A legal, financial and accounting advisers and the underwriting syndicate managing the IPO process (described below under "Advisers"). In conjunction with these advisers, the target company's management will begin preparing for the IPO process and M&A process by collecting, centralizing and categorizing a vast array of due diligence materials that will be required by both processes (described below under "Due Diligence/Synergies"). While the IPO and M&A processes are run in tandem, generally the target company's management, legal advisers and underwriters will begin working to produce a draft registration statement earlier than beginning the auction sale process owing to the significant lead time required to produce a document that can be filed with the Securities & Exchange Commission ("SEC").

Customarily, the auction sale process kicks off at the same time as the initial filing of the registration statement. With the JOBS Act allowing emerging growth companies to submit confidentially, the company must decide whether to issue a press release about the filing or just to contact potential buyers. In either case, the IPO filing gives bidders in the auction a clear signal that the target company is ready and willing to pursue this strategic alternative, and hence, practically introducing a background "bidder" into the process. However, the target company may, for a variety of strategic reasons, delay the filing of the registration statement until the auction sale process has begun and at least a preliminary assessment of the bidders' interest can be obtained by its M&A advisers. The calculus of when (or even whether) to make the filing is usually a function of the target company's assessment of which is the more promising path.

Assuming the dual-track framework remains, the IPO process and M&A auction sale process are then conducted in parallel, with each proceeding according to their customary individual tracks. In the

case of the M&A auction sale, there are a number of due diligence and other meetings/presentations between management and other key personnel of the target company and bidders. If the auction sale is run as a two-stage process, a round of initial bids will narrow the scope of the field and be followed by final bids. After which, a final bidder will be selected to conduct exclusive negotiations with management and its advisers to reach a final definitive sale agreement.

On the IPO path, it generally takes from 60-90 days after the initial submission to clear SEC comments. There is an initial 30-day review period, followed by additional filings approximately every 2-3 weeks until all SEC comments are resolved. While the initial 30 day review period may provide a good opportunity to catch up on company business and launch the M&A process, the subsequent pace of IPO comment responses may make it difficult to simultaneously pay attention to the M&A process.

At the final stage of the dual-track process, assuming both paths have been followed to their ultimate conclusion, the target company will be able to compare the relative valuations offered by an IPO versus an M&A exit. Equally important, at this point, a definitive agreement with the prospective acquirer should be close to final, and the target company's legal advisers will be able to make an assessment of closing certainty (i.e., whether there are regulatory or other approvals to closing that may present an obstacle). It is unusual to run all the way to the end of the IPO process and then sell. Usually, a company will make a decision on whether to sell prior to launching the road show. Once the road show has begun, the most usual path would be to complete the IPO (although an acquirer may launch a final bid either during the road show or even shortly after the company has gone public).

Ideally, having weighed valuation and deal certainty in coordination with its advisers, the target company will at this point have a clear sense of which path to select.

Complexity, Management Bandwidth and Cost

From the onset, it is important to remember that a dual-track process will naturally be more complicated and time-consuming for the target company than simply choosing a single exit strategy. One of the most critical decisions that must be made by the target company at an early juncture, prior to choosing the dual-track process, is a realistic assessment of whether its management will have sufficient bandwidth to devote its energies to preparing for an IPO and an M&A exit at the same time.

If the target company intends to undertake the IPO process as a legitimate avenue to exit, it will need to prepare and file a registration statement and engage with the SEC on multiple rounds of comments. Similarly, an M&A auction process will involve engaging with multiple bidders and responding to their financial and legal due diligence questions, conducting a series of management presentations, evaluating auction bids and, once a final bidder or bidders has been selected, engaging in negotiations with respect to the definitive terms of the transaction. Inevitably, the same members of management will need to be involved in key decisions relating to both processes. The target company and its management will need to consider whether it will be feasible to manage the demands of these dual processes while still devoting the necessary time and resources to the day-to-day operational needs of a late-stage emerging growth company.

Finally, a dual-track process will quite simply be more expensive, since there will be fees paid to lawyers, bankers, accountants and other advisers on two different streams of work.

Advisers

One important decision that the target company will need to make at the onset is whether the same investment banker will represent the target company on both streams of work. The target company will need to consider if it will be best served in using the

same teams for each process. In our experience, most companies choose a lead underwriter who can also serve as the M&A adviser. There is generally only one M&A adviser, and it is valuable to have that adviser basically neutral on the two outcomes knowing that they'll get a substantial fee as either the lead underwriter or as the sole M&A adviser helps ensure that they devote full effort to both processes.

Of course, the preferred financial adviser for an M&A exit may not have the same substantial expertise and experience when it comes to selecting a lead underwriter. Market practices differ on this subject, but it is suffice to say that choosing different sets of advisers for each process will inevitably entail some degree of further complexity and strain on management time. As a result, most target companies ultimately will choose to consolidate their set of legal and financial advisers.

Due Diligence/Synergies

While the time and complexity of a dual-track process is greater than either an IPO or M&A exit alone, one area where there may be significant synergies is the due diligence process. In this regard, it is critical that the target company's management and advisers lay out a clear and systematic due diligence roadmap to ensure that the process is both efficient and coordinated between the two streams of work.

Generally speaking, there is a great deal of overlap in the due diligence materials that must be identified, consolidated and then categorized by the target company for purposes of the due diligence undertaken by the underwriters in an IPO process and potential bidders in an M&A auction sale process. While this task is complex and must be managed in coordination with the target company's legal and financial advisers, the fact of this overlap means that so long as the processes are coordinated, the exercise should be done only once. At its core, the underwriters and potential auction bidders will be focusing their efforts on the same categories of documents in the course of their respective investigations of the target company.

However, it is crucial to also remember that different motivations and concerns will be at play for the target company in monitoring the flow of information in the IPO process as compared to an M&A auction sale process:

M&A Auction Sale	IPO
Phased due diligence process	Exhaustive due diligence
Designed to avoid disclosure of competitively sensitive information until preferred bidder(s) have been identified	Includes competitively sensitive information, with common goal of crafting adequate disclosure

As a result of the competing considerations outlined above, companies should think carefully about how to organize and manage due diligence in the context of a dual-track process. For example, companies should consider whether separate data rooms are appropriate for each process, as well as data room tools to segregate the parties from each track. It is crucial that confidentiality be maintained on the two processes – in fact, the other underwriters may not know that the M&A process is underway. (Recall that only the lead underwriter is likely to get a fee on the M&A process, and it is important that the processes both move forward without interference or premature publicity.) Company management and their advisers will need to keep tight control of this process so that, for example, inadvertent early disclosure of competitively sensitive information is not made to bidders in the M&A auction process.

Advantages/ Disadvantages

While this note does not seek to discuss the respective merits (and drawbacks) of an IPO exit versus M&A exit for a target company's management and investors, it is suffice to say venture capital and private equity investors, as well as management, will each have their preferred path as the dual-track process proceeds. In other words, the interests of each constituency may be different, and it is not

unusual in a dual-track process for each group to attempt to drive the process one way or another.

For example, private equity or venture capital investors may favor a full exit in the absence of a very compelling valuation offered by an IPO, particularly as they are often required by the underwriting syndicate (and the expectations of public investors) to relinquish their control rights post-IPO. Equally, management and founders may each favor an IPO versus a sale to a strategic acquirer; since, in the latter case, there is a greater potential for changes to senior management and founders often wish to retain substantial equity in the company after the transaction. Ultimately, management of the target company should be cognizant that the advantages and disadvantages of an IPO versus M&A sale will not be uniform across the various groups whose cooperation and/or approval will be necessary for the exit to take place at all.

The principal disadvantages of a dual-track process have already been discussed (see above under "Complexity, Management Bandwidth and Cost"), although it is worth re-emphasizing that a dualtrack strategy is a substantial undertaking for management. Resources and time will be spread thin, and there are risks that the operational side of the business will suffer from management's attention to the IPO and M&A sale processes. Moreover, in opting for a dual path and spreading resources accordingly, there is always a degree of risk that neither path will be pursued with the necessary determination to ensure a successful outcome.

The advantages of a dual-track process are intuitive, and are particularly important to recognize in a time where investor appetite for IPOs may have ebbed. For one, the dual-track process presents a target company that is motivated to partially or fully exit with the best prospects of actually achieving this result. IPO windows open and close, and target companies can be caught amidst periods of market volatility or lack of investor demand through no fault of their own. Unfortunately, and

whether rightly or wrongly, a failure in this process often leads to negative market sentiment about the target company's prospects. In this sense, an M&A process (whether it is a full auction sale or entering negotiations with a motivated acquirer) can be a valuable alternative for an emerging growth company seeking an exit.

Second, while a dual-track process can be longer, it also affords the target company with the luxury of waiting until both processes have unfolded, and a comparative valuation emerges between IPO and M&A exits. The ability to delay a decision and to cross-reference valuations is an immensely valuable tool for a target company seeking to maximize exit proceeds. Finally, an IPO process can, if orchestrated and messaged to bidders properly, serve as a valuable tool to increase the target company's leverage in an auction sale process and potentially motivate bidders to expand the multiple they are

willing to pay. Obviously, a key factor in whether this dynamic comes to fruition is whether the IPO alternative is truly believable; however, assuming this to be the case, bidders will realize that the target company is not limited to the universe of bidders in the auction.

Ultimately, the advantages of a dual-track process often outweigh the very real costs of undertaking what is a formidable task. However, any emerging growth company must at a minimum ensure that it understands the costs and disadvantages of the dual-track process, and that in coordination with its legal and financial advisers, devises a clear-eyed plan from the onset that gives it the best chance for success.

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