PUBLIC OR PRIVATE:

WHEN SHOULD A COMPANY GO PUBLIC AND WHEN SHOULD IT STAY PRIVATE?

October 2022

I. Executive Summary

According to Bloomberg, in 2000, during the "dot-com" bubble, the average time between a company's formation and going public in an Initial Public Offering ("IPO") was three years. Now, the average time is nine years. Public reporting company status is traditionally prestigious, increases access to capital, improves liquidity and enables more favorable financing terms and opportunities. Yet public reporting company status exposes companies to the glare of public scrutiny and burdensome compliance obligations, often before they are ready to shoulder those responsibilities and sometimes without raising much capital or increasing liquidity and financing opportunities appreciably. In the meantime, the private equity markets increasingly dwarf the public markets and provide the overwhelming amount of capital markets investment. When should companies go public, and when should they stay private?

II. Public or Private: The Stats

The U.S. Securities and Exchange Commission ("SEC") has compiled valuable statistics on registered and exempt-from-registration securities offerings for FY 2021, ending June 30, 2021, as reported on December 9, 2021 in the FY 2021 Annual Report of the SEC Office of the Advocate for Small Business Capital Formation. According to the Annual Report, in FY 2021 all exempt offerings, including Regulations D, A, S, Crowdfunding, and offerings using other exemptions totaled $3.326 trillion. Reg. D, Rule 506(b) alone was used to raise $1.9 trillion in capital, with a median offering amount of $1.8 million. By way of comparison, U.S. GDP in 2021 was approximately $23 trillion. In other words, exempt securities offerings in FY 2021 were the equivalent of nearly 14% of U.S. GDP.

By comparison IPOs, including SPACs, or Special Purpose Acquisition Companies, raised $317 billion, or less than 10% of exempt offerings, with a median offering amount of $225 million. Other non-IPO registered offerings raised $1.4 trillion, with a median offering amount of $350 million. IPOs and SPACs get a lot of headlines, but they are dwarfed by the private capital markets. For a fuller review of the SEC data, see our "Raising Capital through Private Placements: Deal Points," Section XI, p. 25, available at [Kurtin PLLC Raising Capital](); the SEC Office of the Advocate Annual Report itself is available at https://www.sec.gov/files/2021-oasb-annual-report.pdf.

III. Public or Private: Discussion

There are two main ways by which a private company goes "public": first, in a public offering of a newly-issued specified number of a class of securities (debt or equity) pursuant to section 5 of the Securities Act of 1933 (the "Securities Act") and SEC Reg. C, usually on an SEC Form S-1 registration statement, including a prospectus with highly detailed and exacting financial and non-financial requirements; or second, by registering an entire class of securities (as opposed to a specified number of a class) pursuant to section 12(b) or 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act") on SEC Form 10. Companies can also go public through other means, such as spin-offs; reverse mergers, including the "business combination" phase of a SPAC; or through a "Form 10 IPO," which combines a Reg. D private placement to raise capital, a Form 10 registration statement to register the class of shares sold in the private placement and a Form S-1 registration of the private placement shares for resale (it sounds cumbersome, and it is, but it allows capital to be raised before incurring most of the IPO's costs). Through any of these methods, a company becomes a public reporting company, meaning it must file annual, quarterly and other reports pursuant to Exchange Act sections 12, 13 and 15(d).

But when and why *should* a company go public, and when and why should it remain private? First of all, under some circumstances, a company *has* to register as a public reporting company, whether it wants to or not. A company must register as a reporting company pursuant to Exchange Act section 12(g) if it crosses the thresholds of (i) more than $10 million in total assets and (ii) a class of equity securities that is held of record by either 2,000 or more persons or 500 or more persons who are not Accredited Investors (for an explanation of Accredited Investor status, see our "Raising Capital" Section I). A company must also register pursuant to Exchange Act section 12(b) to list the securities on a U.S. national securities exchange such as NASDAQ. Let's consider some of the public vs. private factors:

1. <u>Costs and Timing of Going Public vs. Staying Private</u>.

<u>Securities Act IPO</u>. A Form S-1 Registration Statement, usually used for an IPO, is an extremely detailed document that includes as its major component a prospectus referring back to SEC Reg. S-K for required qualitative information, such as Risk Factors, Use of Proceeds, Management Discussion & Analysis ("MD&A") and Dilution; and Reg. S-X for required financial statement information. Many of the Form S-1 elements would be familiar to companies that have conducted private placements pursuant to Reg. D or Reg. A as scaled-up, more detailed and rigorous versions of the information to be furnished on SEC Form 1-A (Form 1-A, technically a Reg. A form, is now used for both Reg. A and Reg. D

pursuant to SEC harmonization efforts over the last few years; see also "Raising Capital," Sections I and III).

A traditional (i.e., non-SPAC) IPO typically costs approximately $1 million in legal fees, approximately $500,000 in accounting fees and approximately $500,000+ in other fees, including exchange listing fees, transfer agent fees, FINRA (Financial Industry Regulatory Authority) fees and others, for a total of between $2 million and $3 million in costs. In addition, underwriter fees by an investment bank average 7% of the offering amount raised, for a total of all costs of approximately $10 million, or 10%, of the raise in a $100 million IPO, slightly amortized in larger IPOs. A SPAC IPO typically costs less than a third of those legal and accounting fee amounts, in large measure because a SPAC, as a newly-formed "blank check" company, has no financial or operating history to disclose in its registration statement (see "SPACs: An IPO and Private Equity Alternative" in Kurtin PLLC Raising Capital).

The traditional IPO process typically takes at least 4-6 months, with wide variations for responding to SEC comments and amending the S-1 registration statement in response to those comments, the length of the roadshow to promote the IPO and other factors. Also, a traditional IPO is a company life-consuming event; while an IPO is proceeding, from kick-off to filing to the road show to going effective, it should be assumed that it will dominate the time of the CEO, CFO, General Counsel and many other company players, to say nothing of outside counsel, accountants and investment bankers. Other milestones in the company business plan will inevitably be deferred, and some business opportunities may be lost.

Exchange Act Registration. Registration pursuant to Exchange Act section 12(b) or (g) on Form 10 is considerably less onerous than Form S-1, but nevertheless requires disclosure of substantial qualitative and financial information required by Reg. S-K and Reg. S-X. Costs might run to $50,000 or more, depending on the complexity of the financial and other information being adapted for the registration statement. Once registered, a company will then usually list its securities on an exchange like NASDAQ or NYSE, which have their own listing requirements. The process might take 3-4 months.

Raising Capital in the Private Markets. By contrast, a private placement under Reg. D, Rule 506 in the $25 million-$75 million range typically costs between $50,000-75,000 in legal fees, with accounting and filing fees adding perhaps another $30,000-50,000, for a total of approximately $100,000. All costs are reduced if the private placement is made only to Accredited Investors (see "Raising Capital," Section I). An offering under Reg. A is typically somewhat more expensive because of more stringent requirements, perhaps $75,000-$100,000 in legal fees, and $50,000 in other expenses.

2. The Prestige Factor and Liquidity/Access to Capital.

This factor may have been a more significant driver of the decision to go public in the past than now. The fact that public reporting company status traditionally leads to greater prestige, liquidity and access to capital doesn't mean either that it will for a given company or that those benefits can't be obtained in the private markets. There are plenty of large, prestigious, well-capitalized private companies with excellent access to any needed capital that have never gone public: Bloomberg, SpaceX, Fidelity Investments, Bechtel, Koch Industries, Bain & Co., Platinum Equity, Cargill and others.

3. The Market Maker Factor.

One of the reasons reverse mergers fell out of favor and gave way to SPACs is that a reverse merger, in and of itself, does not raise money for the newly public company, meaning no broker-dealers are making a market for it and no analysts follow it, leading to a phenomenon sometimes called "being lost on the NASDAQ," in which the company's public float has little trading volume and no real opportunity for stock appreciation and there is little of the hoped-for liquidity. At least a successful SPAC IPO raises capital, intended to be used for the second stage reverse merger or "business combination," sometimes called "De-SPACing." Moreover, SPACs often also conduct a simultaneous PIPE ("Private Investment in Public Equity") transaction, a private placement under Regulation D, Rule 506, which raises additional capital.

4. The Public Scrutiny Factor.

This is one of the most difficult parts of public reporting company life, especially for companies that are not mature and still developing their business plan, relatively thinly capitalized, and relatively thinly staffed. When a reporting company issues required annual, quarterly and current reports on SEC Forms 10-K, 10-Q and 8-K, everything significant that it does or that happens to it is immediately disclosed to the public; that is the literal price of access to the public capital markets. Loss of a material contract, key employee departures, volatility in the listed stock price itself are all under the microscope every day. The fact of the matter is that not all companies are ready to handle and manage that scrutiny, and many that manage it do so at detrimental cost of executive attention to executing the company business plan and the best long term interests of the company and its shareholders, rather than ensuring that no news causes a stock price drop.

IV. Summary

A summary of the yield from the foregoing for comparative public reporting company vs. private company advantages and disadvantages suggests that public reporting company status remains, as it has traditionally been, a safer bet for mature, proven companies with large shareholder floats that can assume that the liquidity and financing opportunities traditionally associated with public company status will actually materialize. The prestige factor traditionally associated with public company status may be attenuated; many large, successful and prestigious companies that are "household names" in their sectors are and have always been private companies. The stresses put on early stage companies by public reporting obligations can be major hurdles and sometimes counterproductive to executing the company business plan. The responsibilities and tasks of a public company CEO and CFO are markedly different from those in a private company, and require more salesmanship and stewardship of shareholders, including institutional shareholders, their advisors and market intermediaries like analysts and bankers than expertise in executing the company business plan. Being de-listed from a national exchange such as NASDAQ is a difficult event for any company to come back from, and starting to fail in SEC reporting obligations and having to report those events can be crushing.

Bottom line: with so much capital available in the private markets through exempt-from-registration financing methods, an early stage company should need a real reason to go public.

Owen D. Kurtin