KPMG Private Enterprise

New expectations for companies looking to IPO

Transitioning your business | July 2023

Erika Whitmore:

Thank you everybody for joining us today. My name is Erika Whitmore and I'm an Audit partner and part of our KPMG Private Enterprise Group and host of this podcast. And I'm really excited about today's session. I've got a couple of really trusted colleagues that I work with and really wanted to have them on the podcast today to share their insights on kind of what's going on in the market, what they're seeing with pre-IPO companies, et cetera. So with that, I'm going to turn it over to you, Hillary and Sally, to introduce yourselves. And Hillary, if you want to start.

Hillary Cimock:

Great. Thanks, Erika. And we are excited to be here. So everyone listening, my name's Hillary Cimock. I am a partner in our Accounting Advisory Services in KPMG. And really what we do is help clients with complex transactions, so going through IPOs, business combinations, carve-outs, anything that has to do with accounting and financial reporting, we will work with our clients. I focus on the life science industry, so have a lot of insights into what we're seeing there, and I'll pass it to Sally to introduce herself.

Sally Wong:

Great, thanks, Hillary. My name is Sally Wong. I'm a managing director in Accounting Advisory as well, and I've worked with Hillary in the past, so we kind of do the same things. However, my focus is more with TMT clients, specifically the technology and media clients, as well as a little sprinkle of kind of blockchain and digital assets as well. So I'm excited to be here with you guys and hope we have a good discussion.

Erika Whitmore:

Awesome. Thank you both. And what I wanted to start off with today was just a couple kind of pieces of information from our most recent venture capital pulse. And I'll reference a couple of things at the end of the webcast just so that everybody can go and kind of get access to this information. But if we think about where things kind of landed as of the end of Q2 2023, I would say that we are in an absolute drought when it comes to venture capital investment. Obviously, there's certain transactions that have happened that have been sizable, but outside of that, generally, investing has been down. There has been some investment in generative AI. Obviously that's a very hot area. We do hear critics saying that maybe it's not quite the hype that it's at right now, meaning maybe there's some investment here and not that there won't be things going on with AI, but maybe there's a little more hype because there's not a lot else going on.

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That being said, there have been a couple of IPOs in the last few weeks, which is really, really exciting, but still kind of wait-and-see and more to come. So we will touch on that a little bit and just kind of share what we're seeing with our clients and prospective clients and just in the market in general. But a lot to be seen here, the rest of '23 as well as '24 and beyond, to see where things go with the IPO market and also with VC-backed investing specifically. So with that, and maybe I'll start with Sally this time, just in terms of companies that we are working with or talking to in the market, Sally, kind of what are you seeing right now? What's the sentiment?

Sally Wong:

Yeah, so I think there's kind of two main groups, and with the majority falling into probably the first set I'll talk about, which is started off as a start-up, private enterprise, growing rapidly, getting some traction, and really has companies that have their sights set on an IPO sometime in the 2025 timeframe.

And then the other kind of group of companies, and probably a smaller population they're in, are these companies that may have had a lot of funding from either a currently public company parent who is able to support a lot of their capital needs and the subsidiary that would be potentially going public, has really strong revenue. So these types of companies, their timeline is probably a little bit shorter looking probably closer to the beginning, to mid-2024 timing. But I think for the ones that are a little bit closer, one common thread is that their revenues are really strong. They're focused on profitability, not necessarily growth in terms of types of products, but really profitability and making sure that not only is their P&L strong, that their balance sheet is strong, that they're able to take cash out of the business.

Erika Whitmore:

No, that makes a lot of sense, Sally. And just to reference the Venture Pulse Q2 report again, it was reported that there are more strategics coming into the market and doing some investing. So that's a good sign. Hillary, what are you seeing?

Hillary Cimock:

Yeah, I would say similar in terms of companies wanting to go public, everyone's a little more hesitant than what we saw in 2020 and 2021, but it is those companies that, like Sally said, are able to generate revenue, have a positive EBITDA, have that ability to give returns to their investors. There's a few that I know of in the life science space that are looking to get something done quickly, say in this year, in 2023, at least from an initial filing if they can. But I would say more so it's a, let's get ready and make sure we don't miss the window if it does open. But there's not as much of a rush to get it done today.

Erika Whitmore:

Which I mean, if you're talking to the three of us, and we're obviously going to be biased. Hillary and Sally both know this, but I also work with a lot of pre-IPO companies. That's like music to our ears. If you were to set out a perfect plan, we would want companies to really methodically put together, here's where all my gaps are in terms of being a public company and being able to report timely and being able to forecast. And not that that means you have to share numbers with the street, but you at least have a cadence, you can predict, it's predictable. You have a process where you can predict your pipeline, et cetera. So you're really laying out, here's my gaps, and then prioritizing those and then figuring out what resources do we need to start addressing those gaps.

So Sally had, when we were preparing for this, you had a really great observation, I think from one of our recent webcasts. If you could talk about that a little bit again in the vein of what is it going to mean in the future to be a successful public company, both in terms of size and preparedness?

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Sally Wong:

So I mean, financial reporting hygiene is so important, because you've got to make sure that you are ready to have those public filings, kind of reporting deadlines, whether it's because you got acquired by a public company or because you are now public. But, really, I think the preparation is important to know what your equity story is, to have to your point, Erika, really solid forecasts. And in speaking with or hearing one of the large investment banks speak, they were talking about some insight, which I thought was interesting to say, "Hey, after you go public, I think you tend to garner more interest from your top analysts when your revenues are maintained around kind of the $500 million mark. When you start dropping, you get less attention from those analysts and, therefore, maybe a little bit less attention than, therefore, from the investors as well."

One of the other things that these banks like to emphasize is, "Hey, you don't have to only come to us when you're about to go public." Because I've heard multiple banks being willing to do kind of test roadshows. And in this, it's kind of that gap analysis that you're talking about, Erika, where they come and they present. It's almost like a practice roadshow. And the banks will tell you, "All right, this worked, that didn't, you need to fix it before you go public." Therefore, there's no surprises and really their feedback is intended to help you stay in that $500 million mark, et cetera.

Erika Whitmore:

No, I think that's a really good point and something important to think about. Hillary, anything to add to that?

Hillary Cimock:

Yeah, I would agree. I think that assessment and getting ready is just to make sure that you're going to be successful as a public company, which overall is what every company and every investor wants to happen after an IPO. We all know there was the boom in 2020 and 2021, and our team has done some analysis of those companies that went public, and it was just such a different time at that point. And the hygiene of a company maybe wasn't as good that there are a lot of them that are struggling today. Not only just because of the market we're in and it being kind of a down market, higher interest rates, but just not having the operations or the equity story that makes them consistent and helps them be a successful public company.

Erika Whitmore:

No, I think that's fair. And I think one thing that we talk a lot about, we've talked about it in our webcast and we've talked about it in other events that we've held, is that no matter what your size is, I mean obviously it matters a little bit. But it's just expensive to be a public company and the periodic filings and the rigor and discipline that a company has to have, and frankly the resources, whether they're internal, external, or both are pretty extensive. And so not only do you want to think about are we profitable now? Do we have enough revenue now? And do we have enough room for growth? Is the market big enough? Do we have a compelling story? But are we willing and ready to take on those costs? So I just think that's important. And Hillary, in terms of the, and I'm just going to pull up the notes here for this paper, so the *Liquidity Challenges in a Down Market*, I think, is one of the papers that we've written recently. Is there anything you want to highlight from that article? I thought it was really good.

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Hillary Cimock:

Yeah. And I do encourage people, if you haven't seen it, to download it and read it. It has some really interesting facts and analyses that we were able to glean from these public companies. Like, for example, based on public filings, research on the companies that did go public. I mean, our firm is estimating 174 IPOs and 77 SPACs that went public in 2020 or 2021 could run out of cash within 24 months starting in March of this year. And that's not a long time. That's a pretty short life if they are going to run out of cash. And even with that, of those numbers, 50 percent of them are what we would consider to be in the "distressed zone" or signaling a risk for bankruptcy. And so that's where I think the market is shifting, where companies that are going public, we keep talking about this hygiene, and we want companies to have a really good hygiene before they go public, so that they don't fall into this category of being distressed, having a more difficult time of either raising additional equity, financing, or debt financing when they are in distress.

Erika Whitmore:

Yeah, no, those are some scary statistics for sure. And I do get asked once in a while about the SPAC market, so would love to hear what you all think on that, too. But in terms of what I'm seeing just with my client base and the market is just that SPACs, while they maybe aren't dead, maybe there's some out there that are trying to maintain it is pretty close, but would love to hear what you all think.

Hillary Cimock:

Yeah, I would say it's definitely fallen off. Everyone saw it as a great way to go public, maybe a quicker way using a SPAC merger versus the traditional IPO, but I mean a lot of these companies are just struggling right now to be profitable, to not get into the distress zone. I think it's harder to find the right investors. It's harder to go through that road show that Sally was talking about without having a lot of revenues or without generating a positive EBITDA. So I do think it's still maybe viable for some profitable companies. I think what we saw were some companies that weren't revenue generating as of the merger date, we're going to see that as much anymore.

Erika Whitmore:

And really quick, Hillary, before we flip to you, Sally, any different view on that from specific to life sciences?

Hillary Cimock:

Yeah, that's a great point. I do think, and we've seen a couple of transactions even happening this year where it still might not be that the life science company is revenue generating, but I do think they're farther along in their clinical trials and in getting the data where it is really right, the data is showing that their IP or their product that they're developing has a market, is going to be approved by the FDA. So there is a little bit of a difference from a life science perspective where you could see some, and we have. They're not necessarily SPACs, but we've seen some transactions where a non-revenue-generating life science company is going to go public.

Erika Whitmore:

Or raise money. That it does seem to be a little bit different for that specific industry. Sally, how about you?

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Sally Wong:

Yeah, I think what Hillary said is pretty consistent with what I'm seeing as well in that SPACs have kind of fallen off. I think there's an iteration of what a SPAC is, and that is the reverse merger where instead of a shell public company, you have still an operating company, but effectively after that merger with effectively what was previously referred to as the operating company. They merge with a public entity, but then the private entity takes over; basically the public company's identity and the business shifts to what the private company was. So that's kind of like a variation on the SPAC and that I've seen a couple of those. They're still in the comment letter process, so I wouldn't say that they're successful yet, but I've probably seen more of those than an actual SPAC going forward.

And then with respect to tech companies, the ones that I've mentioned, I think would fall into the tech space. But yeah, it's really hard because I think when companies do go public via these reverse mergers and SPACs, they're subject to more immediate filing deadlines, meaning if you go traditional IPO, if you kind of miss a pricing window or you do decide to push out, you can based on your readiness of reporting, maybe not ideally for economics, but just from a logistical perspective, be able to push out that date to be ready to report. But once your reverse merger or your SPAC closes, you really have no brace period there. So that's kind of some of what these companies are looking at their counterparts who did go public in 2020 and 2021 and looking at them as a cautionary tale. So these companies are really just focused on, "Hey, can I get enough capital from our investors right now to stay afloat until I am able to get capital from the public markets?" And that, as I think you've alluded to before, is fewer and further in between or very expensive.

Erika Whitmore:

Yeah. Because it doesn't seem like it, not to switch gears completely, but it also seems like there's not a whole lot of deals out there right now, meaning companies aren't looking at their performance and taking down what the valuation of their company is, which makes it even harder to get new money in, even though I think there's quite a bit of money on the sidelines. So I'm going to flip back to this Venture Capital Pulse one more time and just remind our audience that we do expect that IPO activity will continue to be somewhat muted in Q3, even though very excited to see at least some activity. I think a lot of companies and investors will be waiting to see how they perform in the market, to see what the plan is for companies that are either ready or will be ready early in '24. So with that, maybe I'll start with Sally and then go to Hillary. What parting thoughts do you have for our audience?

Sally Wong:

Well, maybe a little self-serving, but it's never too early to start being ready to have public company reporting hygiene even as a private company. It may cost a little bit more than waiting to incur that GNA, but I don't think you're going to regret it.

Erika Whitmore:

No, that's a good point. Sorry, Hillary, go ahead.

Hillary Cimock:

No, all good. And just to add on to that, I think there's evidence out there that that's needed, and I go back to this thought leadership paper around the distressed companies that for companies that are not ready, it's a high cost and even could be more expensive if you're not ready before you IPO. So the better prepared you are, the more successful you can be as a public company.

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Erika Whitmore:

Perfect. Thank you both. Well, I really, really appreciate having you both on, and I'm going to really quickly go through some of the reports that we referenced on the podcast today, which will also be on the sidebar of the podcast webpage, but there's three of them. One is the Semiannual IPO and M&A Outlook Webcast that was held on July 21. The second is *Liquidity Challenges in a Down Market*. And the third is the Exit Optionality Bootcamp, which is actually provided by the NASDAQ Entrepreneurial Center, and it was a virtual event held on June 14. So again, Sally and Hillary, thank you so much for being on today. I hope that you'll come and be a guest again, and I really appreciate your insights and I think our audience does as well.

Hillary Cimock:

Yeah, absolutely. Thanks for having us.

Sally Wong:

Thank you.

Erika Whitmore:

Thank you.

Contact

Erika Whitmore
T: 303-382-7717
E: elommen@kpmg.com

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