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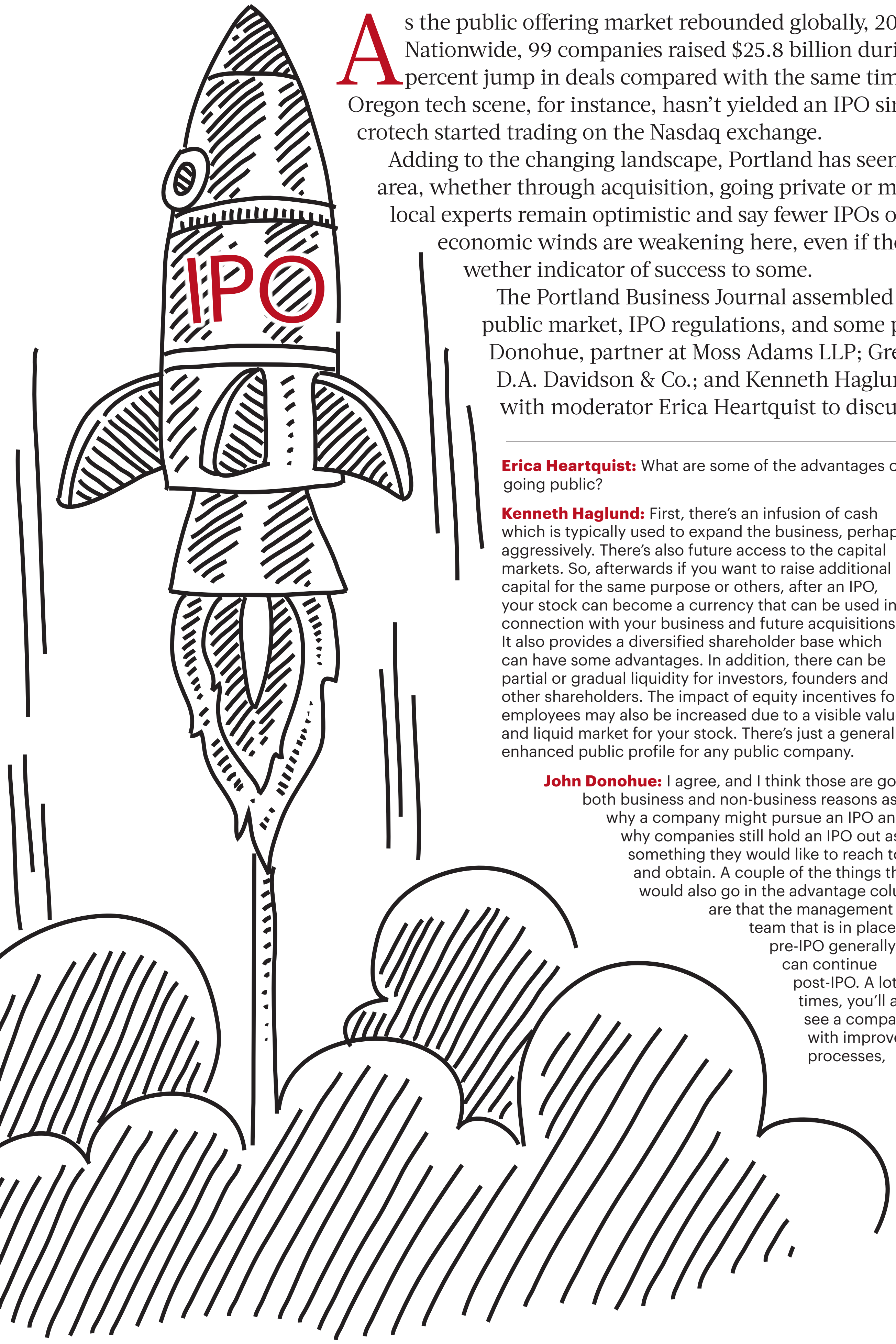
IPOS IN OREGON

THOUGHT LEADER FORUM



As the public offering market rebounded globally, 2017 remained fairly quiet for IPOs in Oregon. Nationwide, 99 companies raised $25.8 billion during the first three quarters of 2017. That's an 83 percent jump in deals compared with the same time last year, according to GeekWire. However, the Oregon tech scene, for instance, hasn't yielded an IPO since 2004, when Beaverton-based Cascade Microtech started trading on the Nasdaq exchange.

Adding to the changing landscape, Portland has seen a number of public companies exit the local area, whether through acquisition, going private or moving of corporate headquarters. Nonetheless, local experts remain optimistic and say fewer IPOs or public company headquarters does not mean economic winds are weakening here, even if the milestone of going public seems to be a bellwether indicator of success to some.

The Portland Business Journal assembled a group of Thought Leaders to talk about the public market, IPO regulations, and some potential relief coming from the SEC. John Donohue, partner at Moss Adams LLP; Greg Thomas, director in Investment Banking at D.A. Davidson & Co.; and Kenneth Haglund, shareholder at Lane Powell PC, sat down with moderator Erica Heartquist to discuss IPOs and the alternatives to going public.

Erica Heartquist: What are some of the advantages of going public?

Kenneth Haglund: First, there's an infusion of cash which is typically used to expand the business, perhaps aggressively. There's also future access to the capital markets. So, afterwards if you want to raise additional capital for the same purpose or others, after an IPO, your stock can become a currency that can be used in connection with your business and future acquisitions. It also provides a diversified shareholder base which can have some advantages. In addition, there can be partial or gradual liquidity for investors, founders and other shareholders. The impact of equity incentives for employees may also be increased due to a visible value and liquid market for your stock. There's just a general enhanced public profile for any public company.

John Donohue: I agree, and I think those are good both business and non-business reasons as to why a company might pursue an IPO and why companies still hold an IPO out as something they would like to reach to and obtain. A couple of the things that would also go in the advantage column are that the management team that is in place pre-IPO generally can continue post-IPO. A lot of times, you'll also see a company with improved processes, governance structures, and maybe an enhanced or improved board. Some people view those as disadvantages to being a public company but frequently they can be assets or advantages long-term.

Greg Thomas: An IPO is a great branding event and can dramatically improve the visibility and credibility of an issuer. However, it's important to remember, as it can often be misunderstood, an IPO is by and large a capital raise. There are very few exceptions when it's not, so an IPO is not traditionally a liquidity event. So, generally speaking, companies that go public are putting cash on their balance sheet and creating liquidity in their equity. The cash can be used to fund growth opportunities, both organic and inorganic, as well as allowing the company to operate with a stronger balance sheet. The now liquid equity can be used as a form of currency that is advantageous for structuring M&A transactions, rewarding employees, and getting people in the community involved in the company's story.

Heartquist: What then, are the disadvantages of an IPO?

Thomas: From a banking and capital markets perspective, once you have made your initial filing to go public you are no longer a private company as you have disclosed the strategic and financial details of your company — such as your gross margins, material customers, cap table, among others. And these details, for the most part, are out there for any individual, including employees and customers, to see. You will also be judged on a quarter-to-quarter basis with immense pressure to hit numbers and maintain guidance. As a private company you have the luxury of developing and executing as you and your Board see fit. However, once you are public you are somewhat cast on the strategy you outlined and are judged on your execution of this strategy on a quarterly basis, with the first couple quarters out of the gate being crucial. It's a different operating mode. It's also important to remember that you are no longer a closely held business as a public company — you have public investors — so you have effectively lost control of your company. This is important as we have seen a sizable increase in activist investing in recent years, with a majority of these activist campaigns focused on sub $1 billion companies.

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JOHN DONOHUE, CPA

PARTNER, MOSS ADAMS LLP

John works with public and private company audit clients in a number of industries, in addition to consulting with clients and engagement teams on a variety of technical auditing and accounting matters.

John has extensive capital markets experience, having completed multiple initial public offerings for clients and secondary offerings in the last 5 years. In 2012, he completed a two-year fellowship in the Office of the Chief Accountant of the SEC, where his responsibilities included consulting on technical accounting matters and monitoring the FASB's standard-setting projects.

While at the SEC, John also participated in the staff's IFRS Work Plan, presented to the AICPA Banking Conference, and consulted with other regulators on a variety of topics. Prior to his fellowship at the SEC, John spent eight years in the Portland office of Moss Adams, auditing public and private companies in a variety of industries.

John currently leads the Oregon region's SEC practice and is a member of the firm's Assurance Services Committee.

GREG THOMAS

DIRECTOR, INVESTMENT BANKING, D.A. DAVIDSON & CO.

Greg Thomas is a director in the Investment Banking group at D.A. Davidson & Co., where he focuses on transactions in the technology sector.

Greg has over a decade of experience advising corporate clients on mergers and acquisitions, including domestic and cross-border transactions, as well as capital raises, including public and private offerings of both debt and equity.

He has closed over 50 transactions representing over $3 billion in value, including several of the firm's most visible deals. He holds a B.S. with honors from Oregon State University in Business Administration with focuses in both Accounting and Finance.

KENNETH HAGLUND

SHAREHOLDER, LANE POWELL PC

Kenny advises public and private companies and financial institutions on mergers and acquisitions, securities and regulatory compliance, corporate governance, and corporate and real estate finance.

He also provides counsel to publicly traded companies regarding ongoing securities compliance, including securities disclosure obligations, periodic reporting and EDGAR filing requirements.

Kenny serves on the Executive Committee for the Oregon State Bar's Business Law Section and is a former chair of the section. Kenny's practice has been recognized by numerous organizations, including The Best Lawyers in America, Super Lawyers and Chambers USA.

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Donohue: A couple other things to consider is the process, whether it's an IPO or another transaction, is inherently uncertain. You'll have a company that'll plan for an IPO and think they're going to hit their window and then maybe the timing doesn't work out. I think that can be mitigated in a lot of cases but there's just that inherent uncertainty to the process. It is also expensive. I think both the IPO process itself and the ongoing responsibility of being a public company — I mean a lot of the quarterly reporting Greg mentioned — that's not cheap.

Haglund: On the ongoing periodic reporting, that's something we often help with and that can be expensive. And, it's just something that every public company has to do. Also, the disclosure obligations are not just for the company but also officers and directors and significant shareholders can have reporting responsibilities. Another disadvantage I wanted to highlight is that it can lead to increased exposure to litigation. Oftentimes if there's an issue, some type of restatement or surprise announcement or a stock drop, it can lead to litigation against the company. If you're doing deals, there's often litigation against the company and the directors with that increased visibility that comes with being a public company. I think that sometimes causes the company to become a target.

Heartquist: What should I do if I want to prepare my company for an IPO?

Thomas: It's important to realize that in the initial public offering process you face heavy exposure very quickly. Everything you are as a company is going to be reviewed and memorialized in an initial filing document. So, working backwards from that standpoint, it's imperative that you hire strong professionals to prepare for the process, including strong executives, namely a CFO, but it's also important to work with well-equipped legal and accounting firms. You will be looking to these professionals to create and maintain a number of critical items that will be heavily reviewed in the IPO process — so they need to hold up and it doesn't just come together overnight. Realistically, the companies that are evaluating the public markets for an issuance are often very sophisticated. I don't think there are many CFOs out there saying, "Oh, I think I'll go public this quarter." This is a long process and most people that are looking to endeavor down this road have been down it before. When reviewing legal and accounting firms it's important to find individuals that have public company capabilities well in advance of your IPO. As the number of public companies continues to dwindle in Oregon, the number of professionals that can assist these companies will decline as well. That said, there are several qualified firms in both practice areas.

Donohue: From a resource standpoint, I think a lot of companies are a little unrealistic in how big of an undertaking it is. Greg highlighted a lot of the external resources needed, but for internal resources, particularly on the finance and accounting side and investor relations, the IPO process puts a lot of pressure and strain on those internal resources. I think a lot of companies make the decision to go public and then they start looking around and saying "We should probably resource up for that decision," and when they do that, they're probably too late. You want to be realistic about what your timeline is, and if you want to go public six or nine months from now, you really should have hired some of those people to be in place three or six months ago. Nobody would go public within a quarter, as Greg noted in his earlier example, but I think there are some aggressive timelines that border on unrealistic and companies can put themselves in a bad spot or make their circumstances more difficult by not thinking through that timeline and making an objective and realistic assessment of the internal resource needs.

Haglund: I might add that, as Greg mentioned, there is perhaps a lack of understanding on what exactly an IPO is. It's not a full exit at the time of an IPO, and I think it's critical that the determination is made that it's the right path. You don't want to start down the road towards an IPO and then go another direction because that adds time and expense. With that said, however, there are instances where a company might engage in a dual track process, whereby the company pursues an IPO and M&A exit transaction simultaneously in an effort to seek a higher valuation than if either was pursued in isolation. If an IPO is the right path for a company, I would plan early, get the right team in place and try to avoid as many potential issues that can come up later as possible — and that requires an in-depth review of your corporate structure, required approvals, stock ledger, material contracts, your business, all that stuff. You want to think about it in advance, early with the right people.

Heartquist: Do you find that sometimes it's not a good idea in that case?

Haglund: It becomes a balance about whether it's the right thing to do for a specific company and their goals. And if the advantages of an IPO don't have any benefit to a specific company, then obviously it isn't the right thing to do. If those advantages outweigh the disadvantages that come with it, it could be worth pursuing. But, it's not for everybody.

Donohue: You do sometimes see people being aggressive on the decision, even if maybe they should take more time, or if a readiness assessment comes back with a borderline conclusion, for various other reasons they'll want to push forward on the IPO anyway. Again, I think that's where a company needs to look internally and ask if the management team is being realistic with themselves. Usually, it's like Kenny mentioned, a third party adviser coming in and giving them a bit of that reality check will help guide the decision making process.

Thomas: There are a lot of companies out there that might be ready from a strategic and financial standpoint, but shouldn't be a public company. There are just inherent factors in their business that make it not the best strategic path for them.

Heartquist: That said, are there better alternatives to an IPO then? For example, I've heard about new "mini-public offerings" under Regulation A.

Donohue: It's a different type of transaction than an IPO. It shares some similarity in the sense that you're raising money from the public, and the offering documents go through the SEC. There are certain caps on the amount that you can raise, and there are reduced reporting obligations compared to a regular IPO. I've found that companies we've talked to that are really interested in doing a Reg. A offering seem to be really focused on a crowdfunding-type model, and a lot of times they don't necessarily want to undertake some of the reporting obligations and maybe even some level of enhanced governance that would be seen in a more typical IPO. Beyond Reg. A offerings or IPOs, you've got other alternatives that are more prevalent now than they were 20 or 30 years ago.

Thomas: From a high level, I believe there are companies that should go down a public company path, there are companies that should go down a private company path and there are some very situation-specific instances where alternative structures might make sense. But, after looking at this for over a dozen years, I think there are different alternatives that come and go in terms of capital sources and they just tend to be around for a couple years before something different comes along. I don't see that many success stories coming from these, but I do read headlines about these alternatives not panning out. So, not to say that some of these alternative capital raises don't work out and they're not viable, but I think there are more traditional and established tracks that fit a majority of companies that are looking to explore them.

Haglund: I think it's important to establish your goals and look at the landscape of options that are available. There's a lot of ability in private markets to reach your goals and avoid the costs of being public, and there have also been regulatory changes that allow companies to stay private longer if they want to. For instance, it used to be the case that if you had 500 shareholders and a certain minimum level of assets you became public and had to start reporting, regardless of whether you completed an IPO. That threshold has been increased. That allows companies to stay private for longer if they want to. With respect to Reg. A, one of the problems with that exemption for so long was that it had a $5 million threshold. That's the total size that the offering could be in a Reg. A offering and also there was no preemption of state securities laws. So, it became an option that was on the books but couldn't be taken advantage of by companies. With the new regulation, what's called Reg. A+, under the Jobs Act, that $5 million threshold has been increased to $50 million, and there is a way to structure an offering that will preempt state securities registration laws. What the SEC is trying to do is implement an option for companies that may not fit the traditional IPO mold perfectly right now. And, companies are starting to take advantage of it. For example, we just saw Arcimoto, an electric vehicle company from Eugene, complete a successful $19.5 million offering pursuant to Reg. A+.

Heartquist: After a company is public, with what obligations will it need to comply? Will the requirements become ever more burdensome?

Haglund: We've talked about periodic reporting with the SEC and that's a big one. There's required annual reports, there's required quarterly and current reports, there's proxy solicitation rules, there are various notices, significant shareholders and directors must do Section 16 reporting, so there's quite a bit of regulatory requirements around just regular disclosure. There's also corporate governance requirements that come through the SEC and whichever exchange a company may be listed on and those typically include majority independence on the board, an independent audit committee, an independent compensation committee, and an independent nominating/corporate governance committee. There's also shareholder approval requirements for equity incentive plans and certain transactions. So, it really is broad and a lot that companies have to watch out for and be aware of. Whether it will become ever more burdensome? I feel like the pendulum has been swinging toward increased regulation for a long time and that's starting to come back. Some of the specific, maybe egregious, disclosure requirements that people have had to pay attention to and make sure weren't missed have been repealed.

Donohue: It's challenging too because I think the standard business risks companies are dealing with have gotten more complex, and a lot of those are

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magnified when you're a public company. For an example, take IT security and every time you read about cybercrime and the risk public companies take from improper disclosure, with the hacking of customer and other personal information, that's a business risk and not necessarily a public company risk, but the issue is that when that happens to a public company there's even more questions around the response, the financial impact, and disclosure to investors. I do think to Kenny's point, there is an increasing realization among a variety of regulators — and not just Congress or say, the Administration, but securities regulators and accounting standard-setters — regarding both the complexity and the potential for disclosure overload, and so for example on the accounting side, we're starting to see some changes come into play that are trying to make standards simpler and less complex.

Thomas: Kenny and John are focusing on the right obligations from a day-to-day standpoint. From my vantage point as a banker, we also see the time requirement from the CEO and CFO to keep Wall Street apprised of their progress as a public company through numerous investor meetings. This may not be a regulated obligation, but companies, especially those that are below $1 billion in market cap, need to spend a considerable amount of time telling their story and attracting analysts to cover them. Once they become "orphaned," meaning they have lost the support of the financial markets, it becomes very challenging to be public and you often lose all of the benefits, but unfortunately keep the costs and obligations.

Heartquist: Since the Administration was mentioned — let's delve a little further into that. Do we expect change under the Trump Administration?

Haglund: The new SEC Chairman, Jay Clayton, has outlined some of his guiding principles, and has said that the disclosure based obligations will not change. But, they're going to look at not just incremental improvements but also cumulative improvements. So, I think that you may see some significant rollback and an aggressive approach to streamlining and stopping some of the repetition, the burdens and make it more focused on what's meaningful. So, I think you will see that over the next couple years.

Donohue: I think there was tremendous business optimism that a lot of business regulations could get changed maybe even this year and I think the reality of governing has probably rolled back some of those expectations. There are certain things that require Congressional action, but others, such as some of the things as Kenny said, will benefit just from having a more business-friendly SEC, and could result in some change and some improvements. I've dialed back my expectations on how significant of a regulatory rollback we're going to see in the short term, but am still optimistic that there will be some needed change and more balance to the process over the next few years.

Thomas: A lot of the changes in recent years have been reactionary. They passed the Jobs Act in 2012 and I believe it was expected to have a much bigger impact on the capital markets. Perhaps some of the benefits have been muted by other Acts that are more restrictive. I am hopeful that Washington will continue to listen to feedback as it still can be highly burdensome to be a public company. While it's difficult to predict which changes this Administration will make, it's hard to ignore that on one hand the market continues to press along at all-time highs, yet 2015 and 2016 were light years in issuance volumes, and 2017 is better but by no means robust. This tells me that we need to see continued deregulation in the new issuance markets.

Heartquist: What are the key issues that the SEC staff is focusing on right now?

Donohue: Part of it is just getting fully staffed and back up to speed. The SEC Commission was operating with a reduced number of Commissioners for an extended period of time and it was very challenging for them to accomplish rule makings or make enforcement cases, and really just conduct business as usual. We've mentioned the new SEC Chairman Clayton was confirmed in May and another Commissioner was recently nominated, reducing the number of vacancies. Once the SEC is back up to 5 Commissioners, that should improve the pace of rulemaking, hopefully, and allow them to get back to their business as usual and start to implement Chairman Clayton's agenda.

Haglund: Once they are back up and fully staffed, like John said – I think the SEC will continue its focus on rooting out any form of fraud – they've been really aggressive in the last couple years, particularly with enforcement actions and I think that will continue. They also are very focused on any contractual restriction to an individual making a whistleblower complaint and so companies need to be aware that they can't put any restrictions on somebody doing that or they could face SEC enforcement. I think they will also focus on trying to make the IPO process and subsequent reporting requirements a little bit easier to do, not changed entirely, but hopefully they will normalize it.

Donohue: And Chairman Clayton has really talked several times about wanting to review rules that are already in place, almost on a cumulative basis – so, not just one rule out of context – but the whole package - and the whole list of obligations for public companies to see if there is room there for relief or removal of duplication or other things to improve the process.

Heartquist: Do you think someone who might not operate within the capital markets in Oregon would be surprised to hear that it's been such a long time since we've had a traditional IPO?

Thomas: It's fairly well documented that there are not that many public offerings in Oregon. If we look back 10 years ago, we had over 50 public companies in Oregon, today we sit around 20. During that period, we had one traditional IPO and it was not a success story. This is a difficult trend to accept, especially when compared to our neighbors in Seattle and the broader U.S. market which, while feeling some of the same trends, have fared relatively better. It has been a macro trend for years that we are losing public companies faster than gaining new ones, but the recent onslaught of exits in Oregon, such as Precision Castparts, FEI, Mentor Graphics, and Rentrak emphasizes the point. This dynamic puts extra pressure on the issuance market and the pipeline remains fairly limited. I mostly follow the technology market and within Portland I think that there's too much pressure on generating an IPO. The technology sector, which is a larger driver of the IPO market, has dramatically improved in Oregon over the last 10 years. Our software scene is robust with numerous successful private capital raises, the M&A traction has been there for the most part, and we have a number of skilled executives, so this should eventually lead to some prospective IPOs.

Haglund: It has been a long time in Oregon and I think it's probably based on a combination of factors. One that comes to mind is that the alternatives have been fairly high functioning with the option of exiting with private equity or a strategic acquirer. We've seen a lot of that and companies have been able to do very well with that and find great partners, and the necessity of doing an IPO hasn't been there but that may change now that 2017 nationally has been a very good year for IPOs and we may see some of that come to Portland or Oregon in the next couple years.

Donohue: I think long term though, when you think about what could be good for a local economic environment, the presence of public company headquarters, and particularly the larger public company headquarters, is significant. A lot of the story lines of the last 20 years have revolved around public companies being sold or moving out of state. I don't have the economic evidence to back it up, but intuitively, it just doesn't feel like a great thing for Oregon or Portland to have such a small number of public company headquarters and all the beneficial economic activity that they generate. To Kenny's point, there have been really good alternatives.

Thomas: So long as Oregon doesn't further impair its ability to attract successful businesses we should have a number of prosperous companies build their enterprises in our backyard. Their success can be measured in many ways, from great VC rounds, to successful M&A exits, but a high profile IPO would surely be welcomed.