

# Why Are More Companies Staying Private?

Meeting of SEC Advisory Committee on  
Small and Emerging Companies

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**GOODWIN**

## Why Are More Companies Staying Private?

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BECAUSE THEY CAN

# Reasons Why More Companies Are Staying Private

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- Large Amounts of Private Capital
- Employees Don't Demand It
- Early Investors Don't Need It...Or Maybe Even Want It?
- Certain Securities Laws Have Become More Flexible
- New Generation Of Entrepreneurs Have Different Priorities
- Negative Press Phenomenon
- CASH, the "New" Acquisition Currency
- M&A = Innovation
- High Costs of Being a Public Company
- Other Potential Pitfalls

# Large Amounts of Private Capital

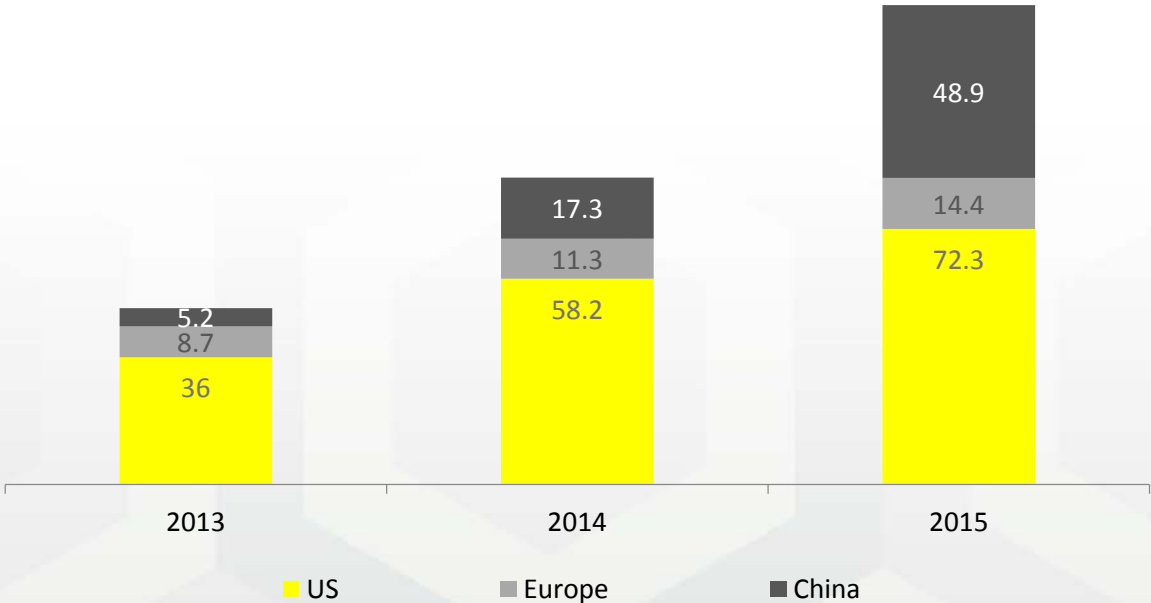
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- Markets are global and awash in private capital
- The types of investors in private companies have expanded
  - VC Funds investing across the growth spectrum from early stage to late stage
  - Traditional Private Equity no longer focused on just buyouts but increasingly on “growth equity”
  - Corporate Venture Capital
  - Hedge Funds have large “private” mandates
  - Sovereign Wealth Funds
  - Mutual Fund Complexes
  - Family Offices
- “Rifle Shot Funds” are commonplace

# Large Amounts of Private Capital

## Global Annual VC Investment

<b>Totals:</b> (number of deals)	5,225	6,801	7,125
<b>Totals:</b> (US\$b)	49.9	86.8	135.6

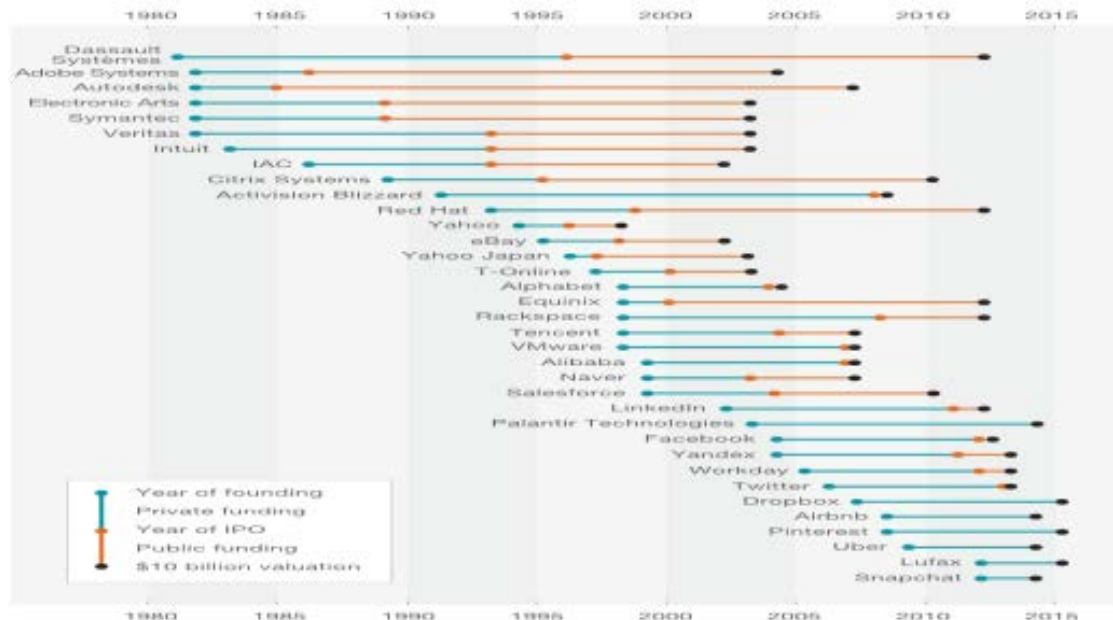


<sup>1</sup> Back to Reality: EY Global Venture Capital Trends 2015, ERNST & YOUNG (2016).

# Large Amounts of Private Capital

- Companies are staying private longer
- The average age of US technology companies that went public in 1999 was four years, in 2014 it was eleven years.<sup>1</sup>

Software companies are increasingly reaching \$10 billion in value without going public.



Note: Only lists companies founded after 1980; 2015 data are preliminary; some companies excluded from analysis if bankrupt or acquired.  
McKinsey&Company

<sup>1</sup> McKinsey&Company (Feb. 13, 2017) (May 2016), <http://www.mckinsey.com/industries/high-tech/our-insights/grow-fast-or-die-slow-why-unicorns-are-staying-private>

# Employees Don't Demand It

- Private Liquidity Programs increasingly commonplace
- Liquidity as a key to winning the “Talent Wars”

“**Yelp** announced that private equity firm Elevation Partners has agreed to make a \$25 million investment in Yelp through the purchase of Series E preferred stock [and a] \$100 million [investment] through a planned purchase of shares from vested employees and other eligible shareholders.”

“This liquidity program will allow our people to focus on growing our business and continuing to create value,” Jack Ma, **Alibaba**’s chief executive, said in a statement. “We believe the high-quality investors making commitments to this important program share our mission and philosophy, and we welcome them as shareholders of the company.”

“**Facebook** announced that Digital Sky Technologies (DST) has made a \$200 million investment in exchange for a preferred stock, representing a 1.96 percent equity stake at a \$10 billion valuation. DST...is planning to offer to purchase at least \$100 million of Facebook common stock from existing common stockholders...”

# Employees Don't Demand It

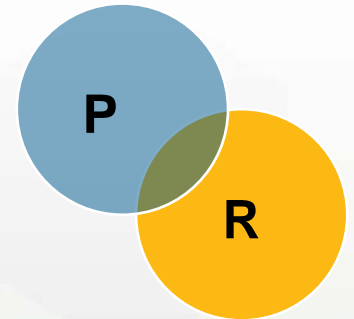
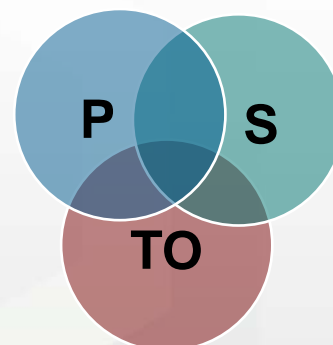
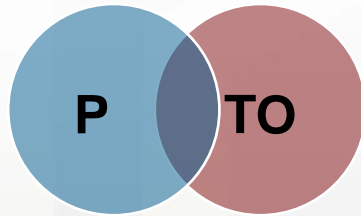
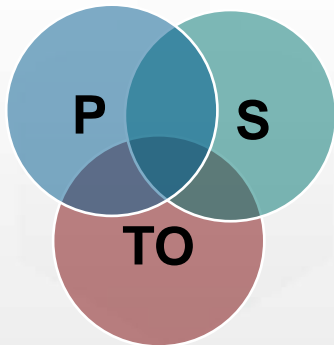
- Secondary liquidity has developed from the “Wild West” to highly structured and controlled Private Liquidity Programs
  - Founder and employee liquidity no longer taboo
  - New technology facilitates efficient liquidity transactions

## Potential Combinations

*P = Primary*

*S = Secondary*

*TO = 3<sup>rd</sup> Party Tender*



*R=Company Repurchase*



# Early Investors Don't Need It...Or Maybe Even Want It?

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- IPO is just another financing event while Secondary Sale or M&A is often a cleaner exit
  - No Lock-ups
  - No ongoing market risk
- Early Stage VCs *selling* to Growth Equity Investors *selling* to Mutual Funds and Sovereign Wealth Funds

# Certain Securities Laws Have Become More Flexible

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- Jobs Act Section 501 – Threshold for mandatory registration from 500 to 2,000 shareholders “of record”
- Fast Act – Section 4(a)(7) safe harbor for secondary sales

# New Generation of Entrepreneurs Have Different Priorities

- Focused on long-term growth
- Focused on control



Mark Zuckerberg

facebook



Evan Spiegel



Jack Dorsey

twitter



<sup>1</sup> Photo credits: Photoshot/Everett Collection; Business Builders Academy; Zumapress.com.

## Negative Press Phenomenon

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- Negative press in public markets largely focuses on profitability, rather than growth trajectory or market cycles



- Private companies can take long-term view and ride out market cycles more easily without same concern for negative press
  - Private companies can increase valuations without providing detailed information to the broader market

# Cash = The New Acquisition Currency

- Historically, going public provided publicly traded shares as attractive acquisition currency
- Today, historically low-rate borrowing environment coupled with ability for late-stage private companies to borrow large sums make dilution caused by using stock consideration in M&A less attractive

\$2B Leveraged Loan



\$2.5B Syndicated Loan



\$1B Debt Financing



<sup>1</sup> Douglas MacMillan and Justin Baer, *Uber Raises \$1.6 Billion in Debt Offering*, WALL ST. J. (Jan. 21, 2015), <https://www.wsj.com/articles/uber-raises-1-6-billion-in-goldman-debt-offering-1421877376>.

<sup>2</sup> Kyle Stanford, *Here's Why the Biggest Unicorns in the World Are Taking on Billions in Debt*, PITCHBOOK (June 17, 2016).

<sup>3</sup> Kyle Stanford, *Here's Why the Biggest Unicorns in the World Are Taking on Billions in Debt*, PITCHBOOK (June 17, 2016).

# M&A = Innovation

- Big Strategics have large cash reserves and must innovate
- Repatriation of overseas cash may accelerate M&A
- Recent acquisitions (since January 2012)<sup>1</sup>

	50
	98
	39
	48

- “Dual-Track” deals continue
  - Cisco acquisition of AppDynamics for \$3.7B (expected market cap of \$1.5B)
  - Stone Canyon Industries acquisition of Mauser Group for \$2.3B (expected market cap of \$1B)

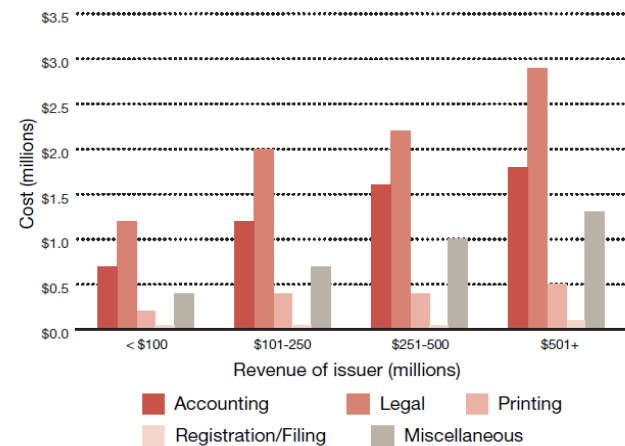
<sup>1</sup> CRUNCHBASE, <https://www.crunchbase.com> (Feb. 9, 2017).

# High Costs of Being a Public Company

- Costs include:

- Costs directly attributable to the IPO
- Recurring expenses of being a public company
  - In 2011, EY estimated that a new U.S.-listed public company can expect to spend, on average, an additional \$2.5 million annually post-IPO
  - Increased costs relate to:
    - Management salary increases<sup>2</sup>
    - Expansion of Board
    - Recurring advisory fees
    - New investments in technology
- Other “Management Attention” Costs
  - Shareholder litigation
  - Compliance
  - Transparency to competition

Offering costs by revenue, excluding underwriter discount



<sup>1</sup> Graph: *Considering an IPO? An Insight into the Costs Post-JOBS Act*, PwC (2016), <http://www.pwc.com/us/en/deals/assets/pwc-ipo-costs-considerations-pwc-deals.pdf>.

<sup>2</sup> *Ernst & Young's True Costs of IPOs Survey Finds Investing in Management Team is Central Element to Companies Going Public*, PRNewswire, <http://www.prnewswire.com/news-releases/ernst--young-s-true-costs-of-ipos-survey-finds-investing-in-management-team-is-central-element-to-companies-going-public-133801088.html>.

## Other Potential Pitfalls

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- Short-Seller Pressure
- Expansion of Activist Investor Environment

“Although several proxy fights in the \$50 bn+ market cap space have garnered a large amount of media attention in the past year, according to Activist Insight data, companies in the \$10 bn+ range have accounted for just 13 percent of all activist targets since 2010,” the study authors write. “By contrast, 71 percent of companies targeted had a market cap of less than \$2 bn, which lends credence to the sentiment of these activists.”

**Adam Brown**

<sup>1</sup> Adam Brown, *Activist Investors Eye Small and Mid-Cap Companies*, IR MAG. (Nov. 23, 2015), <https://www.irmagazine.com/articles/activism/21101/activist-investors-eye-small-and-mid-cap-companies/>.



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