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IPO 'On-Ramp' a Qualified Success

Many new issuers take advantage of Title I of the JOBS Act, but it has failed to induce a flood of public offerings.

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The Jumpstart Our Business Startups Act's most successful section is Title I, the so-called "IPO On-Ramp" legislation. Designed to re-open the capital markets for emerging growth companies, the provisions in Title I allow issuers to meet reporting obligations gradually and submit an S-1 filing confidentially. The provisions are successful in that many companies use them.

As of September 2016, about 88% of emerging growth companies (GAAP revenue of less than $1 billion in their most recently completed fiscal year) have taken advantage of the ability to confidentially keep their initial IPO filing out of the public's eye, according to Ernst & Young.

The appeal of Title I is a "confidential review period with the SEC, where you can get all the bugs and warts taken care of before you release the information to the public," says Wayne R. Pinnell, a managing partner of accounting firm Haskell & White. "It also gives the issuer time to test the waters, to see whether investors are going to buy the deal."

Many emerging growth companies (EGCs) have also chosen to take advantage of the disclosure relief in Title I. Ninety-six percent of ECGs have provided reduced execution compensation disclosures in their IPO registration statements, and 69% have chosen to provide two years of audited financial statements instead of the normally required three, says EY. A large number of pre-IPO companies also plan to exclude auditor attestation of internal controls over financial reporting (called for under Sarbanes-Oxley) following their IPOs, as Title I allows.

While the JOBS Act relaxes some public company reporting, prospective issuers can't afford to look less transparent than their public company peers. For example, only 15% of ECGs have indicated they would follow the easier private company effective dates for new accounting standards. "By following the public company effective dates, EGCs appear to be trying to assure investors that their financial statements will be comparable to those of other public companies," says EY.

While Title I may have made going public easier at the margin, it has not opened the floodgates to the U.S. public markets. Only 105 IPOs priced in 2016, down 38% from 2015. Funds raised dropped 37%, the lowest level since 2003.

IPO filings are also down. One hundred twenty-eight companies filed for IPOs in 2016, the fewest since 2009, according to IPO investment adviser Renaissance Capital.

Why the slowdown? The explosion in private investment capital has obviated the need for many companies to go public, and equity markets have been unreceptive to new deals. "Most companies are trying to stay private longer, and doing progressively longer private rounds," explains Anna T. Pinedo, a partner in the corporate securities practice at Morrison Foerster.

Because the markets have been unreceptive, some filers of S-1s have chosen at the last minute to be acquired by a larger company, as occurred with AppDynamics on Tuesday.

Title I of the JOBS Act also worries some experts. An increasing number of public companies will not be compliant with auditor attestation. In addition to the JOBS Act allowing EGCs to defer compliance with Section 404(b), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 permanently exempted non-accelerated filers (public float of less than $75 million) from its controls requirements.

Based on the number of companies that have gone public since 2012, there could be as many as 700 out of 4,333 listed U.S. companies that do not have to comply with Section 404(b) permanently or temporarily.

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