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Preparing for an IPO

Are you ready?

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Going Public

Why is preparation a key to success?

An initial public offering is a transformational event for an oganisation…

- A company will need to meet additional requirements and continuing obligations as a public company that may require new skill sets, additional resources and changes to the business.
- The IPO process and subsequent public life of the company is highly regulated and puts the company, its board of directors and management under significant scrutiny and subject to additional responsibilities and obligations.

Beginning early to position your company to go public will save fees and, most importantly, time. The sooner you are ready to enter the market, the more flexibility you will have to be prepared to move on an opportune market and the greater proceeds and market valuation that favourable market conditions provide.

The going public decision

Is this the right decision for your company?

Asking and assessing the following questions:

- Why are you planning on going public?
- Does your company have an established and attractive track record?
- Does the company's leadership have a clear strategy and a well thought-out, focused business plan?
- Is the company prepared to be highly visible to the investing public?
- Has the company established strong financial operational and compliance controls to ensure it can meet shareholder and market expectations.
- Do the benefits outweigh the costs of going public?

Companies need to objectively assess their readiness for life as a public company. Going public requires management to be prepared to meet shareholder and market expectations from day one.

The going public decision

Is this the right decision for your company?

Some considerations for shipping companies:

- Investment strategy – Which sector, vessel type, age, profile & technical specifications? Can this strategy be followed consistently in the long run?
- How is management planning to deal with shipping industry cyclicality? Can this strategy be effectively communicated and consistently delivered to investors?
- How can the company differentiate itself from others that are operating in the same sector?

Preparing for a successful offering

Some key first steps

- Put a **management team** in place with sufficient depth and relevant experience;
- Appoint **independent board members**;
- Begin to build a **positive public image;**
- **Build relationships** with investment banking firms and other key advisors (SEC legal counsel, auditors etc.);
- Establish the **group structure**;
- Address **accounting and financial reporting** concerns early;

Establish a strong project management function to ensure initial and robust issue identification, establish a plan, monitor progress, understand interdependencies between workstreams and encourage communication within the project team.

Your going public team

The key players

- Company personnel
- Securities legal counsel
- Investment banker (including underwriters counsel)
- Independent auditors
- Additional sets of hands – accountants, investor relations firm

By appointing key advisors early, management is freed up to focus on the marketing phase of the IPO, where they can add the most value. Management will also be able to anticipate issues and avoid untimely delays.

Putting a structure in place

Some considerations for shipping companies

- New holding entity (country of incorporation?) vs. established holding company?
- Identifying the vessel owning entities to be included in the group. (Typically, individual vessel owning companies are dropped into the new IPO entity upon the IPO).
- Any other vessels in the private fleet (carve-out)? Are the vessels identified sufficiently differentiated from the existing fleet?
- Will the management company be part of the listed group? Will a new management company be established?
- Are the entities that will form part of the publicly listed group sufficiently ring-fenced from the remaining private group (e.g. any joint & several borrowings, cross-collaterisation, management agreements etc.)?

Putting a structure in place (continued)

- Of 25 US listed shipping companies based in Greece:
  - 16 report their management companies as related parties;
  - 9 are subsidiaries of the listed group;
- Even when a third party service provided is used for management services, the services are generally supervised by either a related party management company or a subsidiary of the listed group.

Accounting and financial reporting

Conversion from “private” to “public” company financial statements

- Documentation of critical and judgmental accounting policies
- Revisiting/enhancement of accounting policies in footnotes
- Incremental disclosures to comply with S-X e.g., segments, earnings per share (EPS), pro forma info for business combinations
- Preparation of documentation in anticipation of SEC comments
- Increased attention on auditor independence, requiring the company to prepare its own documentation of key accounting policies

Often, the process of converting to public company financial can reveal unexpected challenges. Allowing sufficient preparation time for this process is important. Commencement of this process as soon as an IPO becomes an optional strategy for the company and its shareholders is recommended.

Accounting and financial reporting (continued)

- Historical financial statements of vessel owning companies to be included in the public vehicle need to be prepared on a combined basis in a carve out situation. These will need to be audited under PCAOB standards.
- A key decision to be made is the accounting framework for financial reporting. For FPI's this is a choice between IFRS and US GAAP.
- Decision is often based on commercial criteria. The investment bank appointed by the company will have a key role in this assessment.
- IFRS versus US GAAP – Key differences include:
  - Vessel impairments;
  - Debt covenants;
- The conversion process is time consuming and can be complex depending on circumstances.
- Currently only 4 out of 45+ shipping companies publicly listed in the US capital markets follow IFRS.

Related Party Transactions

- Privately owned shipping companies generally have many related party transactions.
- As a public company, related party transactions require public disclosure and are scrutinized by the regulator.
- Need to consider significant related party contracts/arrangements prior to going public – legal, management contracts, leases, loans, etc. and how these arrangements may be structured post IPO.
- Transactions that do not follow an "arm's length" principle may also have accounting implications other than disclosure requirements.
- Related party transactions should generally be minimised post IPO and controls put in place to ensure the interests of investors in the public entity are protected. Careful planning to achieve this needs to be performed in the preparatory stages for the IPO.

Internal Controls

The Sarbanes-Oxley Act requirements

The Sarbanes-Oxley Act legislates that companies should have internal controls in place over financial reporting.

- Good internal controls are no longer just best practice; it is a law under the Act.
- Section 404 requires that management has internal controls over financial reporting, which is part of an internal control framework to prevent and/or detect material misstatements to the financial statements.
- This control framework should include documentation of the controls, associated policies, and procedures that contribute to the control framework and documentation, which can be relied on as part of a validation procedure to ensure that the controls are operating as designed.
- The internal control design & implementation phase require careful planning so as not to disrupt existing operations/processes and ensure compliance with the Act.

Internal Controls
The Sarbanes-Oxley Act requirements

- Under Section 302 of the Act, the CEO and CFO of the company are held accountable for ensuring that:
  - The financial report neither contains any untrue statement of a material fact nor omits to state a material fact;
  - All financial statements and information are fairly presented;
  - Disclosure controls and procedures are established and maintained;
  - The disclosure controls cover the whole company, including consolidated subsidiaries;
  - Necessary control weaknesses have been disclosed;
  - Any fraud has been disclosed.
- To meet the requirements of the Act, an internal audit function is required. This can be in-house or outsourced to a third-party service provider other than the Company's independent auditor.

Preparation is the key to success

- An IPO is a complex process requiring the concerted efforts of management and various advisors working towards the same goal.
- The going public process can take between 6 months to a year and by its nature may give rise to unexpected complexities or issues. Early planning and open communication between management and all of its advisors is essential to ensure timely identification of such issues.
- An IPO readiness exercise can help identify issues to be addressed early and provide a roadmap for the company to follow.
- The going public process is just the beginning. Life as a public entity has continuous requirements and imposes significant responsibilities over the company's directors and management.
- Costs of going public can be substantial, need to have a plan to be active in the capital markets in order for the benefits to outweigh the costs.

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