

Strategies for going public

Fifth Edition



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Foreword

Welcome to the fifth edition of *Strategies for Going Public*!

An IPO is an important event in the life of an organization as it seeks to grow. Executing the IPO is the initial step in being a public company. We hope that this publication takes away some of the mystery and uncertainty surrounding the process and acts as a useful guide as your organization begins its IPO journey.

The market for initial public offerings (IPOs) is complex and challenging. The legacy of the financial crisis and the economic volatility that continues to impact the markets have made investors even more diligent in their scrutiny of IPOs.

Legislation passed in the aftermath of the financial crisis, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), has added to the complexity of these transactions, although the Jumpstart Our Business Startups Act (JOBS Act) and the Fixing America's Surface Transportation Act (FAST Act) have provided increased flexibility for companies, particularly for new entrants. Timing remains critical, and being able to take advantage of windows of opportunity is key to a successful IPO.

In light of these challenges, it is extremely important that any organization considering an IPO be well prepared. This fifth edition of *Strategies for Going Public*, created by Deloitte in collaboration with Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates aims to help organizations effectively prepare for an IPO. It provides a straightforward explanation of the process, highlights the common technical terms and language encountered during an IPO, and outlines the new regulatory requirements and procedures that organizations will need to take into account as they seek to go public.

Good luck!



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Chapter 1.

Should you go public?

Going public is a long, involved process that represents a significant milestone for any company.

Introduction

On the surface, the transformation from a private to a public company seems fairly straightforward. A company typically goes public when it sells securities to the general public for the first time. Generally, going public refers to the sale of equity securities, although in some cases it may refer to the sale of debt securities. The term “going public” in this publication refers to those instances where a company files a registration statement with the Securities and Exchange Commission (SEC) for the offer and sale of securities to the public for the first time. The process is called the initial public offering or “IPO.”

The Securities Act of 1933, as amended (1933 Act) requires registration with the SEC prior to the offer and sale of securities, unless an exemption from registration exists. Additionally, the 1933 Act requires that investors receive financial and other information concerning the company in connection with that offer and sale. The Securities Exchange Act of 1934, as amended (1934 Act)—which created the SEC—regulates and controls securities markets and related practices and establishes the ongoing periodic disclosure requirements for public companies.

Exploring the opportunity to go public today presents many challenges due to market volatility, increased regulations, expanded investor scrutiny of corporate governance, and heightened legislative influence. The Sarbanes-Oxley Act of 2002 (SOX), Dodd-Frank Act, JOBS Act, and the FAST Act are examples of more recent legislation that changed the IPO landscape and the requirements for becoming and remaining a public company.

This publication provides information to help you understand the requirements of an offering in light of the changing IPO landscape, including the people you may need to assist you, what your role will be, certain regulations with which you must comply, and what effect a public offering may have on you and your company. Most importantly, it will help you prepare for what to expect as you start the journey toward going public. To assist you, we have summarized the contents of each chapter below.

Chapter 1: Should you go public? Public ownership can provide significant benefits to a company and its shareholders, but it also has drawbacks. This chapter offers you an overview of the process and touches on some of the pros, cons, and alternatives that should be considered before you decide whether this is the right course for your company.

Chapter 2: Is the time right? It is important to evaluate your company's appeal to investors and the state of the market before you decide to go public. This chapter considers several of the factors that may affect shareholders' interests in a company's initial public offering. It also describes some of the key characteristics of a company considering whether to go public. Having a business plan that

incorporates these characteristics can enable you to move quickly and take advantage of market opportunities.

Chapter 3: Your team. Taking your company public requires a team of highly specialized professionals. This chapter identifies these professionals and offers a brief overview of their roles in the process. You should also give consideration to your company's own team. Additionally, this chapter discusses the skill sets demanded in a public company's finance function and beyond.

Chapter 4: Pre-public planning. This chapter deals with the steps that you likely need to take to prepare your company for a public offering. It also provides you with insight into the roles that you can expect your management, attorneys, and independent registered public accounting firm or “auditor,” and other advisers to play.

The prospect of having capital available to finance future growth can be alluring. Yet careful and deliberate thought is prudent when deciding to go public.

Chapter 5: The underwriters. The underwriters are critical to the immediate and long-term success of most public offerings. This chapter discusses criteria to use in selecting lead underwriters and, just as important, some of the market criteria underwriters use in deciding whether they want to take your company public. It also explains the factors that underwriters typically consider when pricing your stock.

Chapter 6: Registration. Everyone on your team will be involved in preparing and filing your registration statement and related documents with the SEC. Your company’s decision to go public is contingent upon the SEC declaring the registration statement “effective.” This chapter reviews the importance of the due diligence process and the makeup of the registration statement, as well as the clearances necessary for your registration statement to be declared effective.

Chapter 7: Marketing the offering. The actual selling efforts principally occur during the weeks immediately preceding the effective date of your registration statement. This chapter describes that process, the rules governing what you can and cannot do and say during the offering process, and what your involvement in the selling effort should be.

Chapter 8: Closing the deal. Once your registration statement is effective and the offering is priced, the remaining events in the process of going public occur very quickly. This chapter outlines those events.

Chapter 9: After you go public. Even before the offering is completed, you must look ahead to your responsibilities and duties as executives and decision makers of a public company. This chapter explains aftermarket trading, your relationship with the financial community, reporting requirements, and certain of the federal securities laws that may affect you.

Chapter 10: Foreign private issuers. Many foreign companies consider going public in the United States. This chapter discusses some of the more important differences between initial public offerings by domestic issuers and foreign issuers.

Advantages and disadvantages
Going public can signify to the outside world that a company has achieved a special level of success. Overnight, a company can be transformed from being a closely held entity

with a handful of shareholders to a company with a large number of holders of its stock, which easily can be bought or sold through a stock exchange or the over-the-counter (OTC) market.

News about the dramatic wealth created for company founders and members of management that follows an IPO can be captivating. The prospect of having capital available to finance future growth can be alluring. Yet careful and deliberate thought is necessary when deciding whether to go public. Opening your company to increased public scrutiny can change the way you do business, and the pressure to maintain growth patterns and meet the expectations of the investment community is typically real and intense. It is advisable to weigh fully the advantages and disadvantages, including those listed in the section below, with a selected group of trusted advisers.

Common advantages
Going public potentially provides both tangible and intangible benefits, including the following:

Increased capital. An IPO can provide your company with additional funds to meet working capital needs, acquire other businesses, expand research and development efforts, invest in facilities and equipment, or retire existing debt. Publicly traded stock can also be used effectively as transaction consideration in mergers and acquisitions.

Improved financial position. As an IPO is usually in the form of an equity-based security, your company may experience an immediate improvement in its balance sheet and debt-to-equity ratio.

Increased visibility. Going public will give your company increased and ongoing exposure through worldwide media coverage of the financial markets, which may enhance your company’s reputation and its brand. Broker-dealers will now be analyzing your company, comparing it

to peer companies, and setting earnings expectations, all of which are highly publicized exercises. Such enhanced visibility and the publicity generated by an IPO may also create opportunities for your company to expand into other global markets in the future.

Less dilution. If your company is at the stage where it is ready to go public, you may command a higher price for your securities through an IPO than through a private placement or other form of equity financing. This means that you give up less of your company to receive the same amount of funding.

Enhanced ability to raise capital in the future. As your company continues to grow, you may need additional permanent financing in the future. If your stock performs well in the stock market, you may be able to sell additional stock or debt on favorable terms.

Liquidity. Once your company goes public, a market will be established for your stock. A public market provides liquidity for management, employees, and existing investors, subject to expiration of a customary lock-up period following an IPO. Subject to applicable laws and regulations, holders of your stock may generally sell it whenever the need arises. However, there are important restrictions to keep in mind that place certain limits on the timing and number of shares that can be sold by certain parties after the offering (see, for example, the discussion of sales restrictions under Rule 144 of the 1933 Act in Chapter 9).

This publication is intended only as a general overview and is not intended to provide legal or investment advice. It does not address all federal and state securities laws, rules of the Financial Industry Regulatory Authority (FINRA), and listing standards and other requirements of the trading markets or other laws, rules, and practices that may apply to an initial public offering, and we undertake no duty to update the laws, rules, and practices that are described herein. Securities and corporate counsel should be involved, and you should refer to the actual laws, rules, and regulations themselves when preparing to go public.

Ease of market valuation. After an IPO, the increased liquidity in your company's shares and the availability of your company's information will enable the market to easily ascertain your company's value. Further, the market valuation of a public company may be higher than its private peers.

Exit strategy. Some major shareholders, such as venture capital and private equity firms, require liquidity in a company. Such sponsors may manage funds with an expected life of less than 10 years. At the end of that period, they typically need to liquidate the fund. By going public, you provide the venture capitalists with the ability to sell their holdings or distribute publicly tradable stock to their fund participants.

Improved credibility with business partners. The simple fact that you are public provides business partners, such as suppliers, distributors, and customers, with more information and can be an indication to them that your company is a business of substance. Prospective suppliers and customers may feel more secure about entering into a relationship with your company. You may also be perceived as a more attractive partner in a joint venture or other similar relationship as a public company.

Better ability to attract and retain personnel. Stock options and other incentive compensation plans enable personnel to participate in the company's success without increasing cash compensation. The chance to acquire stock in the company they work for may motivate employees to take a longer-term view of the company. Additionally, it enhances the company's ability to attract and retain top talent.

Personal wealth. Not insignificantly, an IPO may enhance pre-IPO stockholder net worth. Even if pre-IPO stockholders do not realize an immediate gain by selling a portion of their existing stock in the IPO, they may be able to use publicly traded stock as collateral to secure personal loans. Shares of publicly traded stock are usually more liquid and, as such, can facilitate personal financial and estate planning.

Common disadvantages
There are also some disadvantages of going public that should be weighed against the many advantages:

Loss of confidentiality and increased financial transparency. As a publicly held corporation, your company's operations and financial situation are open to public scrutiny. Information not ordinarily disclosed

by privately held companies concerning the company, officers, directors, and certain shareholders will be available to competitors, customers, employees, and others. Also, information about your company's sales and profits, and executive information such as compensation of your officers and directors, must be disclosed not only initially when you go public but also on a continuing basis thereafter.

Management demands. Top management frequently needs to be available to shareholders, brokers, analysts, and the press. Executives (e.g., the chief executive officer (CEO) and chief financial officer (CFO)) also must be involved in preparing and certifying written information about financial results and other company matters that must be reported to the public and the SEC. This could result in management distraction, which may prevent management from devoting time to operating the business.

There can be considerable internal and external pressures to maintain the growth rate you have established. If your sales or earnings deviate from established trends or from analyst expectations, shareholders may become apprehensive and sell their stock, driving down its price. While a reduced stock price does not have a direct financial effect on a company, it may affect company reputation, employee compensation (through reduced option value if you have options outstanding), and the viability and value of a subsequent offering (causing more dilution to existing shareholders).

Ongoing reporting obligations. Public domestic companies report operating results on a quarterly basis to the SEC. In addition, you will need to disclose certain other events as they occur during the year. This means that parties can now evaluate your company throughout the year, which can intensify the pressure and may shorten your planning and operating horizons significantly.



Less control and more board of directors' influence. The sale of shares to the public will dilute your ownership and may reduce your level of control of the company. In addition, depending on the requirements of your trading market, you are likely to be required to have a board of directors (board) consisting of a majority of independent directors. The board is responsible for protecting your shareholders' interests, and you will need to take into account the board's role in making decisions. In addition, as your ownership is diluted, the possibility of losing control of your company increases.

Greater legal exposure. As a consequence of selling your company's shares to the public, there is greater legal exposure for the company and its officers and directors. Directors have a fiduciary duty to the company, meaning they owe it duties of loyalty and care and so must act in good faith and in its best interests. When there is a decline in stock price, directors are increasingly subject to litigation alleging breach of fiduciary duty. In addition, directors and officers are sometimes subject to SEC enforcement actions in connection with alleged misreporting of financial results or other violations of law or regulations. The offering itself creates exposure under the antifraud rules of the 1933 Act and 1934 Act. All communications, written and oral, relating to the offering or included in periodic reports or other public disclosures, can give rise to litigation for securities fraud if the communications were materially misleading. You will have to become much more formal in your decision-making process. Often, private companies operate somewhat informally with respect to director involvement. That can no longer occur in a public company.

Enhanced corporate governance. In response to the corporate failures and loss of investor confidence during the technology bubble in the late 1990s, the corporate frauds and failures in the early millennium, and the economic crisis of the late 2000s, Congress implemented a variety of

reforms designed to strengthen corporate governance and restore investor confidence. SOX and the Dodd-Frank Act were two of the most comprehensive reforms to be passed since the 1933 Act and the 1934 Act. Both pieces of legislation required significant changes to heighten corporate governance requirements for public companies. The governance listing standards of the New York Stock Exchange (NYSE) and the Nasdaq Stock Market (Nasdaq) increased significantly. In addition, many investors and advisers to investors, such as proxy advisory firms, have their own expectations of best practices in corporate governance that they may communicate to you, either directly or through use of their proxy power. These investor demands can exceed even the heightened regulatory requirements. As a result, corporate governance has become a priority for investors and companies and their boards.

Change in culture and flexibility. Another consequence of selling your company's shares to the public is the possibility of a change in your company's culture. This may be caused by the introduction of new personnel, the loss of personnel, or the company's heightened accountability to its shareholders after the IPO.

Expenses. The cost of going public is substantial, both initially and on an ongoing basis. These initial expenses are discussed at greater length in Chapter 4. There are also significant ongoing expenses associated with periodic public reporting, SEC rule compliance, directors' and officers' (D&O) liability insurance, independent director fees in the form of cash payments, and option awards, as well as with other requirements.

The alternatives
Companies typically make use of a variety of financing options before they even consider going public. Generally speaking, these options should be explored and, where appropriate, fully considered before a company decides on a public offering. The most common way to raise additional capital, of course, is to borrow.

Debt financing can be obtained from institutions such as banks, asset-based lenders, and equipment financing companies. The advantages of debt financings are that they may be relatively simple to arrange and will not dilute your ownership. For many companies seeking alternative funding sources, private placements or venture capital may also prove of interest.

However, exclusive reliance on debt rather than equity may have unintended consequences. When you incur debt, you subject your company to potentially significant financial obligations. A downturn in your business or an increase in interest rates could make it difficult to make your payments or meet contractual covenants in debt financing agreements. Many companies have faltered in this way.

Another common alternative is to sell your business. The sale of a business will often provide quicker liquidity than an IPO. You also will not be subject to the risk of a decline in the market value of the company after a sale. However, if you sell your business for stock of the acquiring company, you should understand the risks associated with the stock and perform the appropriate level of due diligence on the acquirer. Some companies follow a "dual-track" process, meaning they begin the IPO process while exploring the possibility of being acquired. In both instances, you are marketing your company, and many of the early steps in the IPO process can be helpful in an acquisition context. For example, strengthening your internal control over financial reporting (ICFR) framework would assist in the facilitation of your acquisition by a public entity.

The process
Here, in brief, is the typical general sequence of events involved in taking a company public once an informed decision has been made:

Underwriting. Once you have decided that pursuing an IPO is the appropriate

avenue for your company, you typically will invite several investment banking firms, or underwriters, to discuss this possibility. Those who are interested meet with you and your management team to investigate the company's operations and prospects. The underwriters submit proposals from which you make your selection, and the formal process begins. This is covered in greater detail in Chapter 5.

An IPO is most commonly thought of as the initial sale of equity securities to the public. However, there are also other situations in which a company can register debt or equity securities with the SEC for the first time, such as by way of a direct listing, by exchanging debt securities previously issued in a private transaction for registered debt securities, distributing shares in a spin-off transaction by a public company, or registering currently outstanding equity securities.

At this point, you will not have any binding commitments with the underwriters. To help you decide whether to proceed, the underwriters will provide you with an initial valuation range for the company and the percentage of interest in the company that they recommend be sold. There is usually a series of valuation discussions. The ultimate share price and size of the offering, however, are not finalized until immediately before the stock is ready to be sold.

Registration statement. In connection with an IPO, the 1933 Act requires that a registration statement be filed with the SEC before securities may be offered for sale and that a registration statement be declared effective by the SEC before securities are sold. Preparing the registration statement to comply with SEC requirements is a team effort by management, the underwriters, counsel, and auditors, among others. This is usually the most time-consuming

step in the process of going public. When the preparation process begins, an “all hands” meeting is typically held to delegate responsibility for preparing the various sections of the registration statement and to establish a timetable for its completion. When completed, the initial registration statement is filed with (or confidentially submitted to) the SEC. The interval between the initial filing of the registration statement and its effective date is called the “waiting period” or “quiet period,” during which you will be responding to the SEC’s comments and updating the registration statement. There are restrictions on communications during the waiting period, which are discussed further in Chapter 7.

Marketing. Typically, after the company and its advisers resolve all potentially significant SEC comments but before effectiveness of the registration statement, a preliminary prospectus is printed to be used in the marketing efforts. The preliminary prospectus must bear a legend stating that a registration statement related to the offering has been filed with the SEC but has not yet become effective and that the securities may not be sold, nor may offers to buy be accepted, before the effective date. Because this legend is printed in red ink, the preliminary prospectus is commonly referred to as the “red herring.”

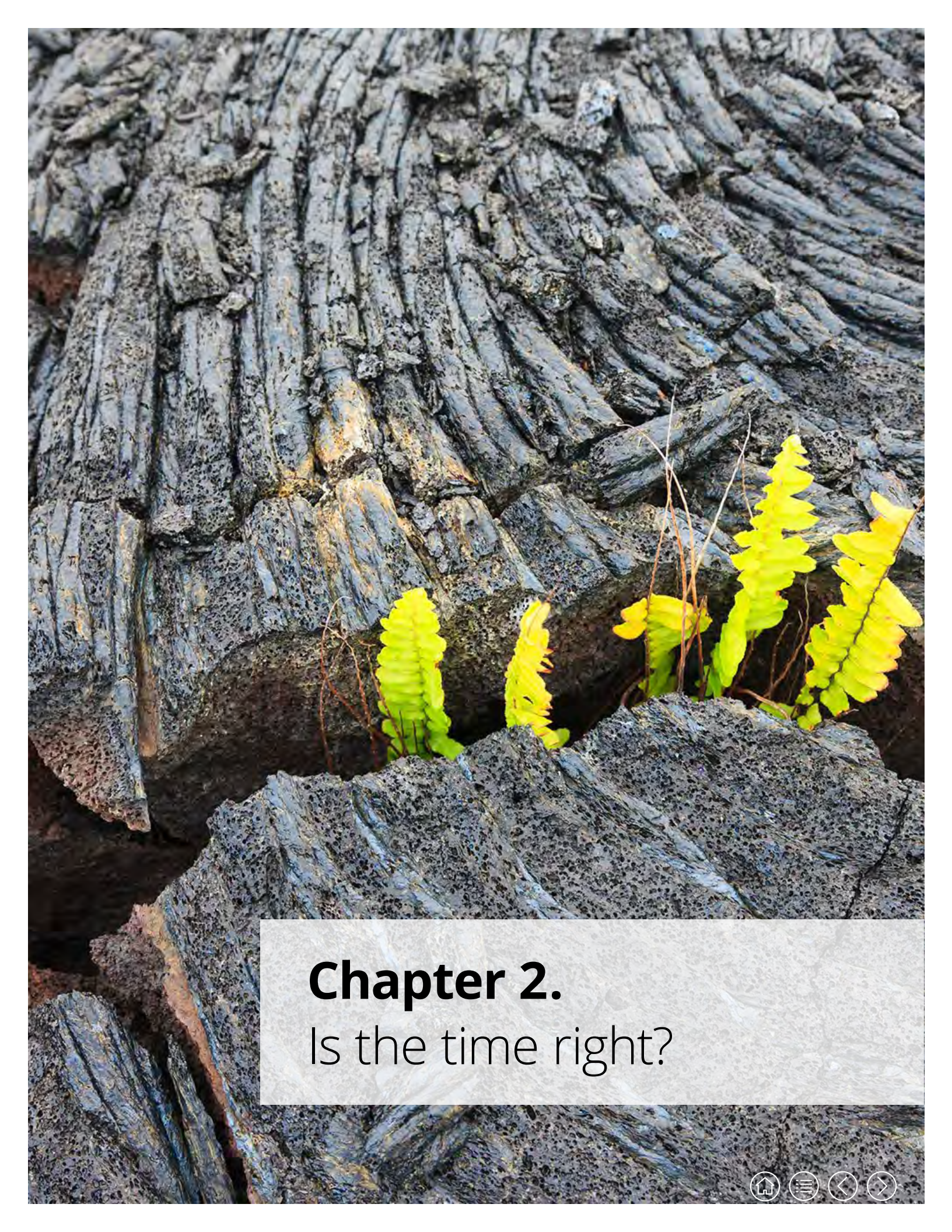
This is the stage, as a practical matter, when the underwriters’ major marketing efforts will move into full swing. By this point, the lead underwriter or underwriters usually have formed a syndicate. As other underwriters join the syndicate, their salespeople begin distributing the red herring to clients and orally soliciting orders. These orders are considered indications of interest only and may be canceled by the customers at any time prior to the sale of the shares. Also, the “roadshow” generally occurs during this period. This is a tour that enables the company’s executives to meet the underwriters’ salespeople and prospective investors. It, too, is designed to build momentum for the offering and is scheduled to end just before pricing occurs.

Typically, on the final day of the roadshow, the company will ask the SEC to declare the registration statement effective. The underwriters and the company will determine the price of the shares to be sold and execute the underwriting agreement, and the underwriters will confirm sales of shares with investors. Trading will commence the following morning.

Closing and sale. The closing usually takes place two business days after the pricing, giving the underwriters time to receive payment for the securities from most of the customers in response to the confirmations of sales that have been sent. Typically, the securities are delivered (though not in physical form) to the underwriters for distribution to or on behalf of their customers, and the proceeds from the sale of stock (net of underwriting discounts or commissions) are paid to the issuer. The underwriters may exercise their over-allotment option within 30 days post-closing, which is described in more detail in Chapter 9.

For a sample timetable of the IPO process, please see Appendix D: A timetable for going public.

Impact on the broader organization While the above items generally discuss the IPO process with respect to the filing and effectiveness of the registration statement, there are many other organizational facets of going public that your company may need to consider as part of the overall process and the impact on the broader organization. It is difficult to predict what changes will occur in your corporate culture as a result of being a public entity. If you decide to proceed, it will be important to plan for the organizational changes that will occur during and after the offering. This publication addresses these other potential changes outside of the actual registration statement filing that should be considered as part of the IPO process.



Chapter 2.

Is the time right?

Is the market ready for your company? Is your company ready for the market?

Assessing the interest that your company is likely to generate in the public market is the first step toward a successful IPO. While there is no universal law to determine market interest, experience indicates that certain features that are indicative of a company's maturity and potential for future earnings are relevant to market appeal.

A focused business plan is an important part of your IPO. It contains future operating projections, such as budgets and forecasts, which are not contained in the registration statement but likely will be essential to you as you sell your story to the lead underwriters. Your management team should clearly articulate a compelling strategy to the underwriters and potential investors to help you realize a valuation reflective of your company's potential.

Any prospective investor in your company will look at a number of factors when making a decision to buy your stock. As the representatives of the purchasers, the underwriters often need assurance on these factors in order to sell your stock with confidence. They need to be enthusiastic about your company's potential and about your industry, they need to be confident that there are no significant negative factors (e.g., heightened susceptibility to technological change, increased competition) that the company cannot handle, and they need to have confidence in the people running the company. As the underwriters also have potential liability for the information in the registration statement, they must be comfortable with the disclosure. Following are some of the factors and questions that are typically addressed.

Product quality and industry potential.

The quality and future of your products in the context of your industry are key. Questions include: What segment of the market are you targeting? What is the growth potential? Who are your competitors? What is the life span of your product? Will you have to diversify or develop new products to continue growing? Does your company have command of its technology and its intellectual property? What products are currently in research and development? What is your product roadmap? Are you in a growth industry? How permanent is your industry?

Management quality. This is a very important factor for investors. Investors will typically only entrust their money to a team with strong leadership. The departure of a key executive just before or after the IPO will potentially affect the company's market competitiveness and raise concerns with potential investors. The underwriters (and investors) also will look at the composition and qualifications of members of the board. Often, a company's board needs to be altered as a part of the IPO process. Your advisers can assist you in doing so as a part of the preplanning process. See Chapter 4 for additional information. Questions include: Do the top managers have the necessary experience? Do they work together as a team? Are they of high integrity? Do they inspire confidence among the company's employees? Are they committed to the company? Are they effective in developing working relationships with customers, suppliers, bankers, auditors, and so on? Is there stability in the leadership team?

Production or service capability.

Your ability to execute operationally on your business plan is also key. Questions include: Are your production facilities or

product-sourcing arrangements adequate to meet the demands of growth? How do your production capabilities compare with others in your industry? Are they adequate to meet the quality requirements of your market? How efficient is your supply chain? What risks are inherent in your supply chain? Are your information systems adequate to support inventory forecasting? What are your contingency plans if there is an interruption in the supply of key raw materials, shipping, or other key aspects of product production? Are you in an industry that is likely to be disrupted?

Employees. A strong employee base is important to the success of most companies. Questions include: What is your human resources strategy? How do you attract and retain top talent? What are your compensation, stock option, and employee benefit plans? How do they compare to others in your industry? Is there an adequate labor supply to support your growth plans? If some of your company's employees are represented by labor unions, how are your relations with the unions, and what is the status of your labor contracts? Are you dependent on only a few key employees and, if so, how are you protecting yourself from the risk of their potential departures?

Financial position. Your current financial position is important in assessing both how much money you will need to raise and the effectiveness of your financial management. Questions include: How well are you managing your assets? How are you financing your working capital needs? Are you providing any financial support to your customers? What financial contingencies exist? How leveraged are you and what is your effective cost of capital? Do you have audited financial statements? Are your accounting policies well documented?



Tax matters. How you are addressing your tax expense and your exposure to tax expenses are important determinations for investors. Questions include: What is the effective rate of tax on operations, and how does it compare with others in your industry? What is the forecasted amount of cash tax payments to be made? Do you have unique or potentially difficult-to-manage tax positions? How would proposed tax law changes affect your tax posture?

Earnings history and potential.

Reported earnings and potential future earnings are often considered as important for public companies as cash flow is for private companies. Questions include: What has your earnings history been? How effectively does your business generate

cash? What is your growth potential? Is there a strong upward trend that is likely to continue? How do you compare (in earnings and margins) with other companies in your industry? Do you have detailed historical and future information about your operations, including sales and gross margin analyses by product or product line, sales channel mix, geographic sales breakdown, and headcount trend reports?

Company reputation. Investors will consider your reputation in making investment decisions. Questions include: How do suppliers, customers, experts, and others in your industry assess your performance? How does the public perceive your company? What kind of relationship do you have with your customers and your suppliers? What types

of related-party transactions has your company entered into? How committed is your company to social responsibility and sustainability initiatives?

Company categories

A company that offers the investment community a high-risk/high-reward opportunity likely will be held to evaluative criteria that differ from those applied to a company that is perceived to be a long-term solid performer. Taking this into account, most companies typically fall into four general classifications: early-stage, high-growth, long-term solid performers, and spin-offs.

Early-stage companies

Some companies' potential so captivates the public's focus that they easily can

attract funds. These companies receive considerable attention when they go public even though they may have yet to produce significant revenues. Some of these companies are bolstered by the strengths of a promising industry, such as clean technology, social media, biotechnology, or deep learning/artificial intelligence, while others rely on the past performances of similar enterprises that have achieved significant growth. More typically, however, early-stage companies have reached the point in their development where most of the technological, manufacturing, and marketing risks have been substantially reduced, and their stock can command a higher price than venture capitalists are willing to offer. The market appeal for this type of company is heavily influenced by three factors:

- **Market opportunity.** An industry that can support significant growth.
- **Potential industry leadership.** An unproven company needs a product or service that indicates it is on the leading edge in its field.
- **An experienced management team.** Management personnel demonstrate the capability to deal with anticipated growth and maintain the company's leadership position.

High-growth companies

High-growth companies also offer the potential for significant future growth, and they have typically matured beyond the "start-up phase" to attain certain levels of revenues and profitability. The market most readily accepts companies of this type that have achieved the following:

- **Sales.** With some exceptions, annual revenues of at least \$100 million suggest an established company.
- **A growth track record.** The investment community generally looks for an annual growth rate of 25 percent or more with the ability to maintain that rate in the next few years.
- **An experienced management team.** Generally, institutional investors want evidence that the company

does not rely on the talents of a single entrepreneur. Normally, the founder is surrounded by experienced executives with responsibilities for key management areas.

Long-term solid performers

These midsize companies often have a long and continuous record of strong sales and earnings. They may not be nationally known, but they offer the public a long-term investment at a reasonable price-earnings ratio (calculated by dividing the price per share of common stock by earnings per share) and are likely to pay dividends. Despite their profitable history, established companies may go public for several reasons, such as to fund acquisitions or provide liquidity to their owners. In many cases, they have revenues of several hundred million dollars; a large and stable or growing market; and a profit history equal to or better than the industry average.

Spin-offs

Diversified companies, many of which may already be public, may not be commanding the market value that their components may realize. A continuing market trend is for such companies to spin off business units as a way of realizing shareholder value. Companies across many industries have spun off portions of their companies, taking the spun-off company public, with existing shareholders receiving shares in the spun-off entity, which then trades separately from the original company.

Is the market ready for your company?

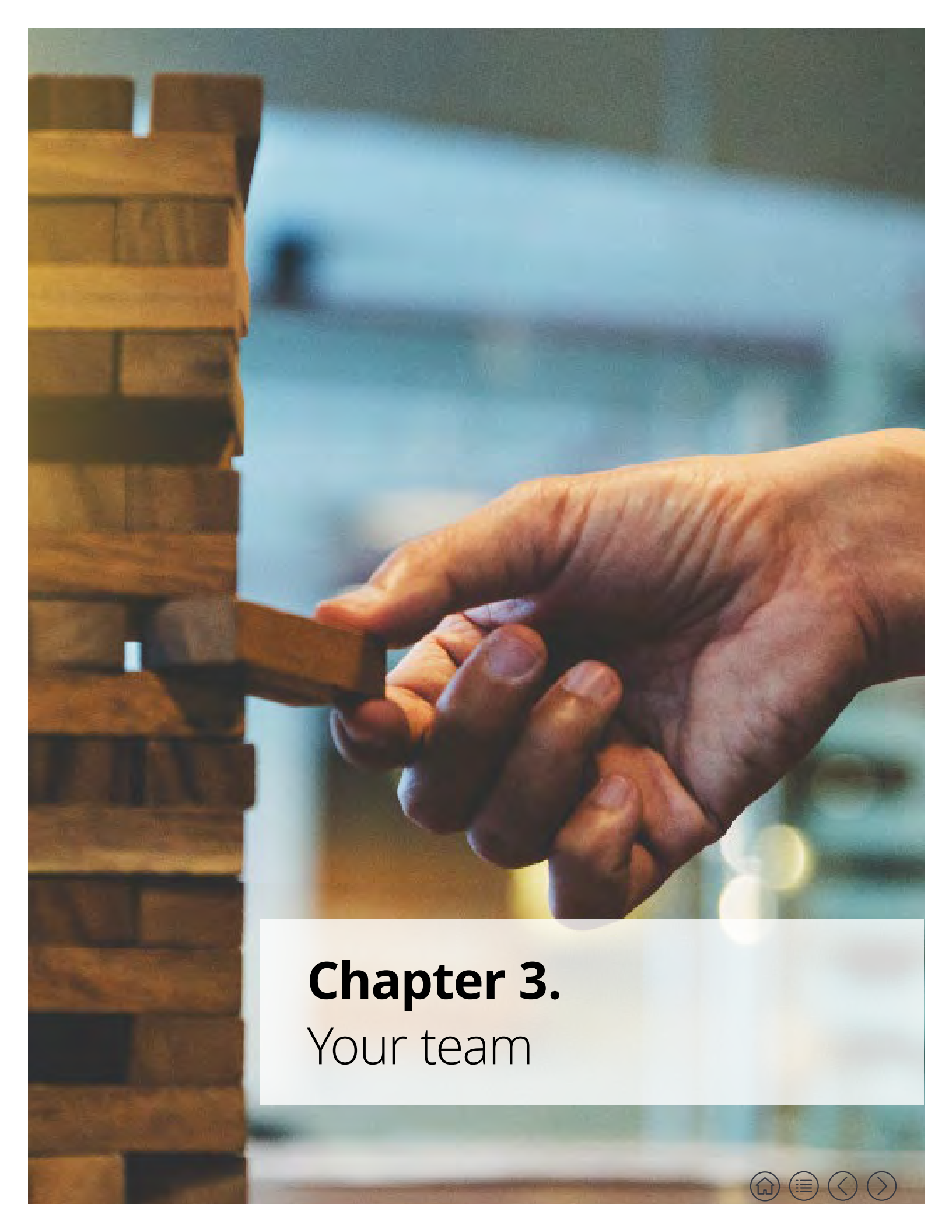
The market can be influenced by a variety of factors, including economic forecasts, domestic and international political events, global and local trends, interest rates, and inflation. A company that might easily attract public funds in a bull market could run into considerable resistance in a bear market. When the market becomes depressed, declines in value are generally greater for newer, less-established companies and those in "riskier" industries.

If an offering is fortunate to catch a rising market, an IPO may produce a windfall of capital. Finding the ideal offering window can be tricky. You should rely on thorough preparation, the expertise of your IPO team, and patience to guide your company through the decision on timing. You should be prepared to adjust your IPO timetable as required by changing market conditions. At the same time, consideration should be given to alternative financing, such as that provided by mezzanine venture capital investors, to protect the company in the event of an unanticipated "closing of the IPO window."

What if the offering is terminated?

The market opportunity to successfully consummate an IPO can be quite short, and on occasion (due to a variety of reasons) companies terminate their proposed offerings before the securities are sold. A company may be ready to complete its IPO but may find that the market is not supportive. This could be due to industry factors, economic factors such as market volatility, or other events outside of the company's control.

Terminating a public offering before it is finished does not affect the ability to sell securities in a private placement after a short period of time or to sell the company. In both cases, much of the work performed in connection with the public offering can be utilized in either the private placement or the sale transaction. Chapter 4 discusses financial reporting considerations of deferred offering costs when an IPO is terminated, and Appendix B: Registration exemptions includes a summary of certain registration exemptions.

A close-up photograph of a hand placing a wooden block on a Jenga tower. The tower is on the left, made of many wooden blocks. The hand is on the right, holding a single block and about to place it on top. The background is blurred, showing what looks like an indoor setting with some lights.

Chapter 3.

Your team

Taking your company public requires the talents of a variety of highly specialized professionals.

In addition to having a qualified management team, taking your company public requires the expertise of other professionals, including underwriters, counsel, and auditors. The array of professional service providers, and the time demands made on company management, will be costly. However, these costs are simply part of the price of going public. The success of the IPO and the future prosperity of the company depend in part upon the talents of this team, so you should resolve to engage the most qualified team possible.



In a company's annual proxy statement, it must disclose why the company has selected to either separate or combine the roles of the chairman of the board and the CEO.

Management

Throughout the IPO, management will serve as the visible representatives of the company. The importance of management's impression on the investment community should not be underestimated or minimized. Investors typically place enormous weight on their perceptions of management's abilities. Thus, management's qualifications, ethics, and experience likely will be highly scrutinized. One way to address this is to make a concerted effort to retain executives who are experienced in building a company and taking it public and who have a strong reputation without prior ethical violations. Executives with a successful history of corporate growth can substantially help to steer the company through a successful IPO.

The organizational structure usually includes a CEO and a CFO. Additional executives that may be useful depending on the industry are a chief risk officer, chief information officer, chief technology officer, and (depending on the size of the company) a chief operations officer. Most public companies also have a general counsel, head of human resources, and head of investor relations.

Management is essential in both the preparation and marketing of the offering. During the pre-filing period, management's intimate knowledge of the company is important in ensuring the company's story, as told in the registration statement, is accurate and complete. After the filing, the centerpiece of the marketing effort is the roadshow. This is a tour by top management with the lead underwriters to a number of locations to allow management to meet with potential investors to present strategic, financial, and operational information and answer questions. See Chapter 7 for additional information.

Management is also the link between the IPO team and the company's board. It is important that the board is fully supportive of the IPO. Members of the board of directors will need to sign the registration statement, and they assume securities law liability exposure as a part of the process of going public.

Board of directors

SOX and subsequent legislation have placed significant emphasis on the role of a public company's board in overseeing the activities of the company. The board and its structure—its skills and knowledge, process, behavior, and how it communicates—are critically important. Regulatory requirements mandate that public company boards comply with enhanced independence standards, maintain specific committees, and clearly articulate prescriptive responsibilities in their charters, as well as other requirements. Furthermore, as the ownership base changes, companies and boards may be subject to the governance policies of institutional investors, proxy advisers, and governance rating agencies. Corporate governance issues should be addressed in the early planning stages of the IPO process, as these changes may take time to implement. Additional corporate governance matters are discussed at the end of Chapter 4.

Attorneys

Going public is a highly technical legal process, and you will work closely with your outside counsel as they assist in your offering. Securities legal work is very complex and highly specialized, and the company and its directors and officers who sign the registration statement risk serious financial penalties, as well as shareholder lawsuits, if the registration statement omits material facts or contains material

misstatements. It is extremely important that you have legal counsel with prior SEC experience and knowledge of the intricacies of working with the SEC. Your counsel should also have significant IPO-specific experience.

Your counsel assists in the process of preparing the nonfinancial sections of the registration statement and responding to the SEC's comments. Experienced securities counsel can also speed up the process significantly, which can reduce costs and allow for a more effective marketing process. They also advise you in the pre-public planning stages. Your attorneys will be able to understand your company's current state and perform an assessment of the gap between where you are today and where you need to be in order to go public. This represents a critical part of the pre-public planning stage because the better the plan is from the start, the smoother the IPO process will be for your company. In addition, your attorneys can assist you in other ways throughout the IPO process, such as by making introductions to underwriters to ascertain their interest in your IPO and compiling data so that you may evaluate the compensation proposed by the underwriters.

In connection with the registration statement, your attorneys will opine on the validity of the stock being issued and sold in the IPO, and at the closing, they will issue a legal opinion on a variety of subjects, and a negative assurance letter regarding the registration statement and prospectus, in each case, addressed to the underwriters to assist in the due diligence process. After the IPO, your attorneys may assist you in ongoing compliance governance and financing matters.

Auditors

An important part of the pre-public planning effort is to assess your company's financial "side of the house" to determine whether it will satisfy strict SEC and underwriter demands. One step is to consider your

external auditor relationship. Your external auditor should be a qualified public accounting firm that has significant SEC experience and is registered with the Public Company Accounting Oversight Board (PCAOB). Many companies choose to engage the services of an international professional services firm because of their industry specialization and extensive SEC experience.

Throughout the IPO, management will serve as the visible representatives of the company. Management is also the link between the IPO team and the company's board.

In addition to completing the audit of your financial statements and review of any interim financial statements for the registration statement, your auditors will also render significant assistance in the registration process. They will read any other financial data to be included within the registration statement and, in doing so, may be able to highlight concerns the SEC may raise and help you address these in the filing. They will also assist in the responses to the SEC's accounting-related comments. All of this will reduce the possibility of subsequent delays. Clearly, your auditor's role is a large one that would be best facilitated by establishing a good working relationship early in your company's development. In this way, your auditor can serve you better through their in-depth knowledge of your company's particular situation.

Your auditor also will furnish comfort letters (see Chapter 6) to the underwriters, which assist the underwriters in performing their investigation of certain financial and accounting data that is included in the registration statement.

Underwriters

Lead underwriters, or investment bankers, lead the marketing of an IPO. These professionals are selective in their acceptance of clients and likely will conduct in-depth research into your company's management, products or services, finances, and business plan before accepting your company as a client. A key task for a lead underwriter, after accepting a client, is to determine the value of the company according to industry and market analysis.

The lead underwriters will be joined by several other underwriters selected by the company to market and sell the securities. If the stock falls below the IPO price during its distribution, your lead underwriters may seek to stabilize the stock's performance. (The role of your lead underwriters is extensive and is discussed in greater depth in Chapter 5.) In many cases, a successful IPO signals the beginning of a long-term relationship between your company and the lead underwriters. Remember that even though you are the client of the underwriters, there are some inherent conflicts of interest between you and the underwriters.

Most importantly, the underwriters have preexisting relationships with most of the institutional customers who will be buying your stock (as well as the stocks of other companies that are being offered on an ongoing basis through the underwriters). The lead underwriters will engage their own counsel in connection with the offering. Underwriters' counsel will be active in the IPO process in representing the underwriters' interests in the transaction.

Accounting advisers

Many companies elect to utilize separate accounting advisers to assist in the preparation for an IPO, as the types of advice or services will not be restricted due to independence requirements. In your pre-public stage, your accounting advisers can assist you by focusing on your business and

providing the guidance and support that you will need to help you steer your company through the IPO process and beyond. Many growing companies need advice on other key issues associated with growth, such as the size and additional competencies necessary to staff an accounting, tax, external reporting, and finance function in a public company; assistance with required disclosures; and general business planning advice.

Tax advisers

Tax advisers can add value to IPO planning by highlighting material income or transaction tax issues that could lessen the success of the IPO prior to the offering. Specifically, they can assist in determining the direct and indirect tax consequences of the planned use of IPO proceeds and can compare and assess possible corporate reorganization options for effective tax rate planning. Tax advisers can also aid in benchmarking the tax efficiency of the enterprise compared to similar public companies, and make determinations regarding the availability, accuracy, and timeliness of tax information used for financial reporting.

Financial printers

The SEC maintains strict guidelines on the format for documents that it will accept. Documents are filed by electronic submission to the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Financial printers remain abreast of the filing-related SEC requirements and are accustomed to the time constraints and confidentiality issues involved in their work. Typically, printers maintain facilities with conference rooms and other amenities that accommodate the unique conditions that often surround the preparation and filing of documents with the SEC.

Transfer agents and registrars

Transfer agents and registrars maintain shareholder records and issue or cancel

certificates to reflect changes in the ownership of a company's shares. In addition, transfer agents assist in processing stock transactions, complying with the requirements of the Internal Revenue Service, and coordinating shareholder correspondence and dividend payments. Transfer agents may also act as the company's proxy agent, exchange agent, or mailing agent. Registrars (usually part of the same firm) keep track of the issued stock. Your attorneys or accounting advisers typically can recommend a reputable firm. During the IPO process, the same firm also may act as the custodian and/or paying agent in connection with the sale of securities by any selling shareholders. You should engage transfer agents and registrars early in the process so that the sale of the securities can occur smoothly upon closing.

Others

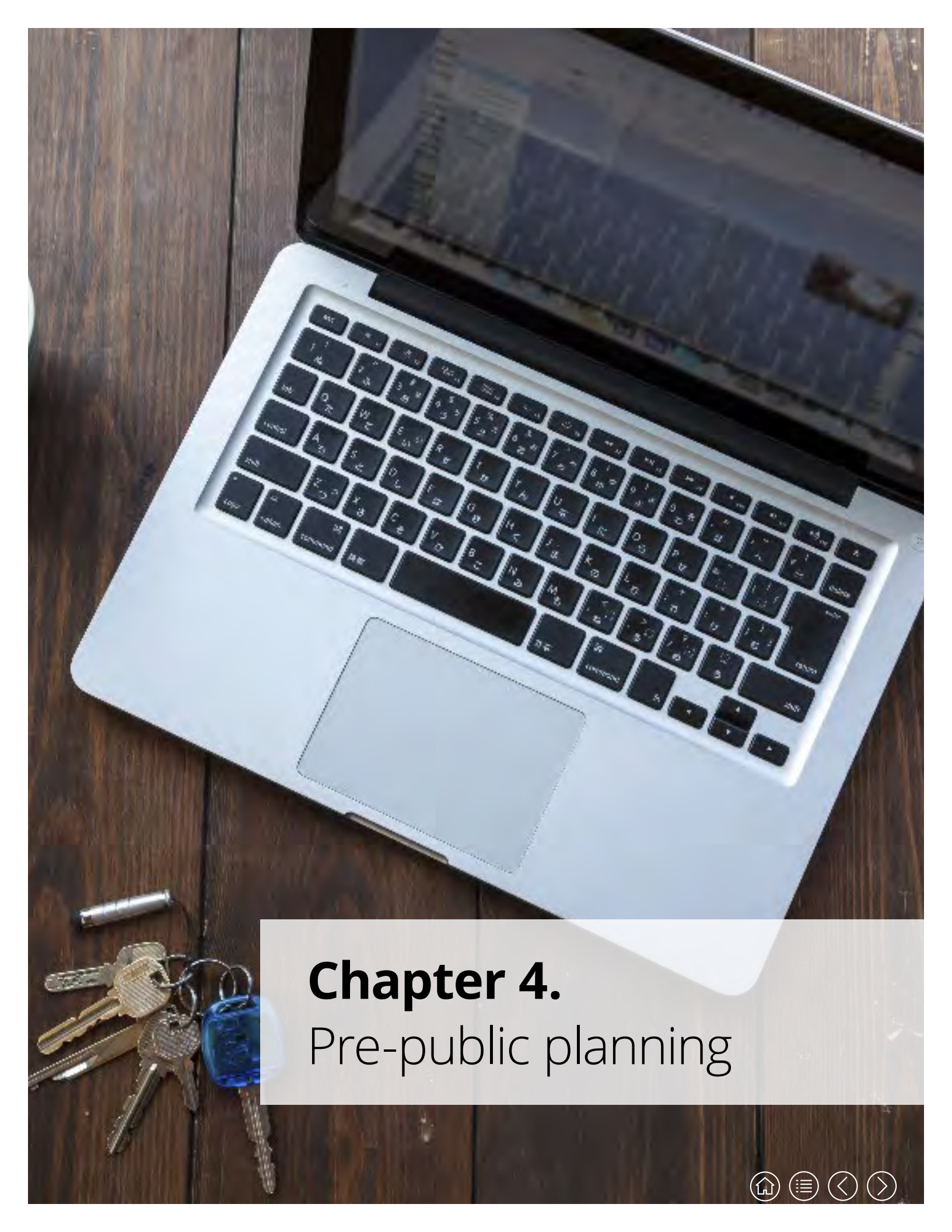
Hiring an investor relations firm can be worthwhile to consider prior to an IPO and as part of a company's broader communications strategy. An effective campaign can serve as a means of increasing the public profile of your company. While you can maintain your prior level of business communications (such as for product announcements), companies must be extremely careful about communications even before filing the registration statement. (For a discussion of the restrictions on communications during the IPO process, see Chapter 7.)

After the offering, the role of investor relations is critical. These efforts can work to retain existing shareholders while attracting new investors, thereby maintaining or raising the stock price. Often, when the marketing effort stops, your public visibility is reduced. Building effective investor relations takes time, and you should consider cultivating a relationship with a reputable firm as early on as possible. Your underwriters, attorneys, or auditors typically can recommend an

experienced firm. Another option for your company to consider is to bring the investor relations function in-house. As the effective date of your IPO registration statement draws closer, your company may want to explore the option of establishing an investor relations resource whose primary responsibility is to facilitate communications between your company and the investment community.

In addition to establishing a dedicated resource, your company should also consider establishing a corporate communications director who is responsible for developing and implementing the communications strategy, as well as having oversight over all written communications, including electronic and printed communications with staff, contributions to company publications, marketing materials, websites, and client/community engagement communications.

Building effective investor relations takes time, and you should consider cultivating a relationship with a reputable firm as early as possible.

A silver laptop is open on a dark wooden desk. The laptop screen shows a blurred image of a building. To the left of the laptop, there is a set of keys with a blue keychain and a small silver USB drive.

Chapter 4.

Pre-public planning

Once you decide that you want to take your company public, you are embarking on a journey.

Going public is not something you do in one day or one month. It takes long-term planning and many months, or sometimes even a year or more, to effect. This pre-public planning is necessary both to prepare to sell stock and to demonstrate to the lead underwriters that you are ready to be a public company. From the start of the IPO process, the better prepared you are, the faster you can respond to windows of opportunity in the capital markets. Your IPO readiness can inspire greater confidence from investors and underwriters, which may increase the likelihood of a smooth IPO process.

Increased formalization

Running a private company for a handful of investors is vastly different from operating a public company for a large number of shareholders. As a public company, your actions will be much more visible, thereby requiring you to be more formal and transparent in managing the business and complying with all the requirements imposed by federal securities laws and the exchange on which your stock trades. You should be aware of the consequences well before you transform your business into a public company. (Some of the most significant post-IPO requirements are discussed in Chapter 9.)

We recommend you and your management team be appropriately staffed to accept these added responsibilities. As a best practice, you should begin operating as if your company were public well before you

- formally seek to go public. This means the following:
- Maintain adequate records and internal controls
 - Produce monthly financial statements for internal reporting purposes
 - Generate reliable and meaningful monthly financial statements on a quarterly basis

Accounting and finance departments should expect to have monthly and quarterly closes that are as accurate as a year-end close. This is crucial on a prospective basis when filing quarterly reports on Form 10-Q with the SEC. Private companies can generally prepare their financial statements on an annual basis without any accelerated timeline. In contrast, following their IPOs, newly public companies are often challenged to meet filing deadlines when preparing periodic reports, especially quarterly reports on Form 10-Q, because there are more tasks to complete in a shorter amount of time.

Additional considerations impacting your IPO timeline and quarterly reporting thereafter should include the time required for: drafting the Management’s Discussion & Analysis (MD&A) section of the prospectus (and subsequent Form 10-Qs), calculating the quarterly tax provision, obtaining sub-certifications from lower-level management as to the accuracy of the financial reports, and establishing disclosure controls and procedures and audit committee review. In addition, you may be asked to present historical quarterly information for inclusion in your prospectus.

In light of the many accounting and financial reporting matters that must be addressed prior to becoming a public company, you

should evaluate the capabilities and staffing of your accounting and finance departments to make sure you have the personnel necessary to understand and manage these additional responsibilities. Furthermore, you should consider hiring additional employees, other than management, who have experience with SEC reporting.

Management should also begin designing, implementing, and documenting its internal control processes. Once the company is public, subject to certain transition periods, the SEC requires all public companies to have disclosure controls and procedures in place. The implementation and ongoing monitoring of these controls should be an important focus of the entire organization from top to bottom. In order for this to be effective, it will require significant involvement from management, as well as oversight from your company’s audit committee.

Furthermore, the SEC requires the CEO and the CFO to certify that they are responsible for establishing and maintaining disclosure controls and procedures to evaluate their effectiveness, and to report the results of their evaluation.

Ongoing financial analysis should be performed and reported to management. Typical monthly reporting packages include, at a minimum, information that will permit the analysis of sales volume and pricing trends by product or product line; sales by major customers, sales channels, and geographic regions; and headcount trends. In addition, major balance sheet items (e.g., accounts receivable and inventory) should be supported with appropriate analysis.

In receiving timely financial information, managers can discipline themselves to analyze operations and results more frequently and accustom themselves to the pressure of quarterly performance evaluations. This level of preparation is an important step in avoiding financial “surprises.”

Bring your stock ownership records up to date. One of the more time-consuming aspects of preparing the registration statement can be determining the current ownership, both direct and beneficial, of your stock and agreeing on the details of stock information for the registration statement and related financial statements. This includes determining whether all the proper formalities were observed in the issuance of the stock, from both a corporate and a securities law perspective, and identifying any existing registration or other rights that shareholders may have. It also means addressing any issues related to employee stock options and other stock-based compensation plans, including ascertaining all unexercised options that have been granted and determining whether these options have vested. If not addressed sufficiently in advance, these matters could lead to costly delays in the registration process. The SEC often raises valuation issues with respect to recent stock issuances or the pricing of recent option grants if the pricing is significantly below the likely initial public offering price (so-called cheap stock). You should discuss these matters with your legal and accounting advisers before you start the IPO process.

Corporate housekeeping

Once you make the decision to go public, you will likely need to do a substantial amount of preliminary work not directly related to the preparation of the registration statement. Attorneys refer to this as “corporate housekeeping.”

Determine whether the company is legally positioned for an offering.

Counsel’s role in the offering will begin with advising you as to whether you even

undertake an IPO. Consult with counsel to determine whether any pending litigation could affect the company’s ability to go public. In addition, you may have arrangements, such as royalty agreements, that need to be revised before you are marketable as a public company. You, together with counsel, should also examine whether you are generally in compliance with applicable regulations, including compliance with the Foreign Corrupt Practices Act (FCPA), export controls, and environmental regulations.

Conduct business through a clear organizational structure. A company that is going public should have an organizational structure suitable for public investment. Many closely held businesses are conducted by a number of corporations under common ownership or by combinations of business entities. They can be operated as limited liability companies or as Subchapter S corporations. Both provide for pass-through tax treatment that can be more tax efficient. The company should carefully consider how its current business structure may affect the increased financial reporting requirements of a public entity. Considerable tax, legal, and financial systems work may be required to reorganize the various entities by mergers, liquidations, and other restructurings.

Simplify the capital structure. Some companies planning to go public have to make significant changes to their organizational or capital structure. Even when the business has been operated as a single corporation, the capital structure may need revision. You may need to simplify a complex capital structure by redeeming dilutive securities, such as stock warrants and preferred stock, or converting them to common stock. You may need to amend your corporate charter to authorize the issuance of more shares to be sold in the IPO. If you currently have only a minimal number of shares authorized and outstanding, you may want to split the stock (or in the case of a very large number of

shares outstanding, use a reverse stock split) to bring the number of shares and the price of the stock to an acceptable level for the offering. While planning for these actions should occur early in the process, often they are completed simultaneously with the consummation of the IPO.

A public company is required to disclose incentive-based compensation, as well as policies that allow the company to recover the compensation in the event of a financial restatement. The scope of the “clawback” provision applies to any former or current officer for the three years prior to any restatement. Therefore, these incentive-based compensation arrangements should be considered in light of how they will appear to the public.

Review organization documents. The charter and bylaws of a private company often contain provisions that are not suitable for a public company. These may include preemptive rights to purchase equity securities; requirements of a supermajority approval to amend the charter, approve mergers, or change of control transactions; unconventional quorum requirements; and dual classes of common stock. It is easier to obtain shareholder approval to amend the charter prior to going public. Consider whether the state of incorporation is most friendly to the company as well. If a company is currently incorporated in a state in which the laws are not flexible in terms of corporate governance or do not insulate officers and directors from liability, the company may want to reincorporate under more favorable laws. Also consider whether the organizational documents should include anti-takeover provisions designed to discourage unsolicited or hostile takeovers. Consider market views on staggered boards, stockholder rights plans, and other protective measures.

Review all related-party transactions and material contracts. Generally speaking, you will need to depersonalize your business before taking it public. The SEC requires full disclosure of significant related-party transactions. You must disclose the names of highly compensated individuals, the amount paid to them, and any special arrangements made with them. Shareholders' agreements providing for rights of first refusal may have to be canceled; personal loans made by the company to directors or executive officers of the company are unlawful under SOX and are required to be repaid; the fairness of the terms of contracts (such as leases) between the company and insiders should be adequately documented and, if necessary, altered; and employment contracts, stock option plans, and stock purchase plans may have to be entered into, revised, or canceled.

You should review all material leases and contracts, updating or amending them to reflect their current terms or to provide more flexibility. You should determine whether any require consent in connection with an IPO or in connection with a corporate restructuring prior to an IPO. You should also consider whether there are any provisions that must be kept confidential and not disclosed or filed. This can all lead to delays in the registration process.

You should review your balance sheet and off-balance sheet assets (such as intellectual property) to determine whether you can verify the legal ownership and existence of all your assets. You should make certain that you have all the documentation regarding your outstanding loans and notes and that there are no provisions that may cause you to be in default as a result of the actions you intend to take in going public.

Anticipate major company initiatives. During the registration process, you should consider the consequences of undertaking any significant company initiative. A major initiative in the middle of your registration

process may necessitate revisions to your prospectus, additional filings with the SEC, or a new circulation of the preliminary prospectus. To avoid any possible delay in registration, the impact on the offering of any major initiative should be evaluated. It may be beneficial to complete (or abandon) major acquisitions and new royalty and lease agreements, and to finalize the establishment of any new management compensation program and changes in key personnel and directors before you start the IPO process.

Review financial statements. The SEC requires that your company's finances be sufficiently detailed and your financial statements audited in preparation for your IPO. You should engage an auditor or change auditors as early as possible to identify any unforeseen financial obstacles that may have detrimental consequences if uncovered later in the IPO process.

Determine if your company qualifies as an "emerging growth company" (EGC). An EGC is defined as an issuer that had total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year. EGCs are exempt from, or subject to, reduced compliance with certain regulatory requirements for a limited period of time. Determining if your company qualifies as an EGC early in the process will help you establish what information you will need to include in the registration statement and assist in your planning for post-IPO requirements. (See Appendix F).

To prepare your company for an IPO, begin to think about operating as if your company were public well before you formally seek to go public.

Financial statement preparation
General
Under current SEC rules, domestic companies (other than EGCs and smaller reporting companies) must include three years of audited annual financial statements in an initial registration statement. EGCs and smaller reporting companies may include only two years of audited annual financial statements. In addition, unaudited interim financial statements may be required, which would require certain review procedures on interim financial statements by the company's auditors.

There are certain situations where additional sets of financial statements may be required to be included in your company's registration statement. If your company has recently grown through significant merger and acquisitions activity, or if an acquisition is probable, financial statements of the businesses that were acquired or may be acquired may also need to be presented. If your company has a significant investment accounted for under the equity method of accounting, a full set of financial statements of the investee may be required. Separate financial statements of financial guarantors may also be required. In the event that any of these situations is present, the additional sets of financial statements may need to be audited, which could require the coordination of the counterparty's audit firm and your own. Companies also should consider adoptions of new accounting standards, such as those relating to revenue recognition, credit loss methodology, and lease accounting, which may require significant time and resources for companies to adopt and prepare required financials.

As the SEC requirements are complex, you should check with your legal counsel, auditor and accounting advisers early in the process to be sure you understand the specific requirements. In some cases, the underwriters may require you to have more periods of information audited than are strictly required by the SEC to give

potential investors more information. You should reach an understanding with your underwriters on any recommendations that go beyond SEC requirements early in the process. See Chapter 6 for additional information about the financial statements required in a registration statement.

Audits

Due to the extensive audit requirements, many companies establish a relationship with an auditor very early in their development and have annual audits performed even if the shareholders or debt holders do not require them. Then, once the decision is made to go public, audited financial statements will be available. Having a two- or three-year audit performed in the process of going public can be time-consuming. Consider performing annual audits in the years leading up to your IPO, as well as including the additional required disclosure in your financial statements. Further, you should keep adequate records to be able to determine quarterly results, if necessary.

If your company currently utilizes a smaller or regional accounting firm as your independent auditor, your underwriter may suggest that you switch to a more nationally recognized public accounting firm prior to your IPO. Keep in mind, however, if your company decides to change independent auditors, the new auditor may need to re-audit the financial statements for all of the years that will be included in your company's registration statement. Another option would be to have the new auditor only audit the current year, while keeping the prior year(s) audited by the predecessor auditor. In this scenario, both your new auditor and prior auditor would be required to review separate portions of the registration statement. You should weigh the pros and cons of each option and make a determination based on the timing and associated costs. Issues highlighted at an early stage in the process can be tackled before the IPO, potentially saving both time



and money and minimizing public company reputational risk. Furthermore, it may be more difficult to have a two- or three-year audit performed as part of the process of going public for several reasons:

It may not be feasible. If you have significant inventories, your auditors generally need to observe and test your annual physical inventory counts in order to issue a “clean” opinion for each of the years under audit. This cannot be done after the fact, except possibly by a costly audit of a “rollback” of a current physical inventory.

You may be surprised by the audit results. Income results and trends may not be as you had expected due to material audit adjustments and may lead you or the underwriters to cancel or delay the IPO. By this time, you will have incurred substantial costs. In addition, your previous financial statements may not be sufficient for an IPO as prior audits would have been performed under American Institute of Certified Public Accountants (AICPA) standards and for the IPO, the audits need to meet PCAOB standards. Some accounting guidance is effective for public companies before it is effective for nonpublic companies. You may be required to retrospectively adopt an accounting policy because your financial statements are prepared on a historical basis.

Further delays could result. A two- or three-year audit is time consuming and could delay the registration process by several months. A few months' delay could mean missing the window that would be most advantageous for you to go public.

Despite the potential difficulties described above, the auditors can generate useful suggestions to organize your accounting records, internal controls, and processes. For example, prior to the IPO process, it is recommended that the company document its internal controls and processes. The auditors can provide valuable insight into documentation of best practices as you move forward with these tasks.

Tax considerations

An IPO also presents new challenges in tax and treasury management. Your company should consider the following:

Tax issues associated with the transaction. Certain sections of the Internal Revenue Code (IRC) may reduce the value of net operating losses and other tax attributes when an ownership change occurs as a result of equity issuances. As such, the company's ability to offset its future income with net operating losses from prior years can be limited. Similar provisions exist within state statutes. Planning for this prior to a public offering can help increase your company's future utilization of net operating loss and credit carryforwards.

Compensation and benefits. There are several compensation and benefits tax implications. For example, the tax code may affect the timing of deferrals of elections in addition to setting limits on distribution. If your company has deferred compensation plans, you will want to consider whether existing or future plans will be in compliance. The tax code can also have implications on transaction success awards, existing severance and incentive plans, stock options, and appreciation rights, among other plans. Deductions for compensation in excess of \$1 million paid by certain publicly held corporations to top employees may be disallowed. Your company should consider and confirm whether this may be relevant to any new compensation arrangements. In addition, a company considering an IPO should also confirm whether or not existing employment agreements or documents have a payment event upon an IPO that would qualify as excess parachute payments. Such payments can be nondeductible and cause significant excise taxes to be levied on the recipient. You should consult with your tax adviser and engage your underwriter in these planning discussions.

Global tax rate. Your company should model its prospective global tax rate and then benchmark it to similar public companies. As the overall IPO structure is being determined, it is the perfect time to consider a tax-efficient structure.

You should evaluate repatriation strategies and transfer-pricing policies, as well as review accounting methods.

Tax operations. During the global review for consistency of use, it is important to consider tax resources, both internal and external, required of a public company. This includes assessing your capabilities with respect to financial reporting as a public company. Your tax resources will be included in your financial reporting framework and may be required to provide

a sub-certification to support disclosure controls. In addition to developing or increasing tax internal controls, your company will need to monitor financial and information technology operational changes for necessary updates to tax processes. As discussed in Chapter 9, public companies have periodic reporting requirements that will necessitate the need for timely and accurate tax accounting information. Further, increased disclosure will be required. Consideration may be given to using external resources, but, as discussed in Chapter 9, independence standards are more restrictive for public companies.

Tax considerations in business growth. Changes to the business through an IPO will have direct and indirect tax consequences and may also create potential tax opportunities. You should consider and evaluate the tax efficiency of capital movement following an IPO and the implications of any modifications to the current debt structure. Further, the usage of IPO proceeds may give rise to particular credits and incentives that should be explored.

A positive image in the market Just as your company goes to great lengths to create a favorable public image for its customers, products, and services, it should try, to the extent legally permissible, to create a favorable image for the people who will buy your stock or can influence that buying decision. These people include analysts, brokers, the business media, and specialty publications that follow your industry from a financial standpoint. In the 24/7 media world of today, effectively utilizing blogs and other forms of social media and networking sites can also help create a favorable public image of your company.

The following are some additional ways you can start developing a positive image:

Begin an investor relations program. Name recognition can be a very important factor in pricing your stock, but it cannot be developed overnight. As discussed in Chapter 7, the type of publicity you can seek out is limited once you have made the decision to go public. Consequently, it is important that you develop your public image with the appropriate people at least a year before you plan to go public. In these conversations, do not mention any possible offering. You may wish to consider engaging an investor relations firm that is experienced in working with the business media and analysts. Many entrepreneurial companies publicize one or two key individuals, such as the founder or a chief scientist or technologist. Analysts and the business media, however, like to probe more deeply into the company. You should certainly continue to focus attention on your key individuals, but demonstrating your depth of management and operating talent can be just as important.

Make presentations at conferences and trade shows. Trade associations, investment banking firms, venture capital firms, and business media organizations frequently have conferences at which companies can present themselves to the media and analysts. If these exist in your industry, arrange for a presentation of your company. In addition, analysts frequently attend major trade shows and technical conferences to keep abreast of products in their fields. The key analysts will likely attend shows where you exhibit. Make a special effort to demonstrate your products or services and introduce your key managers and engineers, but limit your discussions to nonfinancial information or publicly disclosed financial results as applicable to your ownership status at that time (for reasons further discussed in Chapter 7).

Update your company's website, and effectively utilize social media and networking sites. The way we communicate is continuously evolving. Stay abreast of relevant blogs and social media outlets to effectively market your product and brand. Know your target market and potential investors. By knowing these, you can utilize the most effective means of reaching your target audience and reinforce a positive image of your company.

Again, with any marketing activity, you must be mindful of "gun jumping," as discussed in Chapter 7. You are strongly encouraged to speak with your attorneys prior to participating in any of the foregoing or other communications-related activities if you are contemplating embarking on an IPO.

Costs of going public

The costs associated with going public are significant, but there are opportunities to control these costs. The main costs come under the following two categories:

Underwriters' expense

The underwriters' discount, or commission, is typically the largest single cost of going public. It is negotiated between you and the lead underwriters. Factors that affect the discount are the size of the offering, the type of underwriting (see Chapter 5), the going rate for offerings of similar size and complexity, and the efforts perceived to be required to sell your stock. In smaller offerings, underwriters may seek other compensation, such as reimbursement for some of their expenses, warrants to purchase stock, or some other arrangements. All of the compensation paid to the underwriters (or related persons) is subject to review by FINRA to ensure that it is not "unfair or unreasonable." An IPO cannot proceed until FINRA has reviewed the compensation paid and to be paid to the underwriters. This is discussed further in Chapter 6.

Effective pre-public planning can help limit the number of unexpected issues that arise during the IPO process and manage the costs of going public.

Out-of-pocket costs

Apart from the underwriters' discount, you will incur significant out-of-pocket costs, primarily for professional adviser fees (accounting and legal), audit fees, and printing.

Effective pre-public planning, as discussed herein, can help limit the number of unexpected issues that arise during the IPO process and manage the costs of going public. You can get a sense of the out-of-pocket expenses for other IPOs by looking at the SEC's website (www.sec.gov) for registration statements filed by other issuers in connection with their IPOs. Item 13 in Part II of the registration statement summarizes the offering expenses of the issuer. Keep in mind, however, that each offering is unique and costs can vary a great deal. For example, if unusual problems or circumstances develop, such as an unforeseen accounting surprise, the costs could increase substantially.

Legal expense. Legal fees are incurred for the preparation of the registration statement, negotiation of the underwriting agreement, offering structuring, corporate governance, housekeeping, due diligence, and other matters that arise during the IPO process. If the housekeeping is extensive, for example, requiring a complex reorganization or the negotiation of significant agreements, the legal fees will be higher. The fees will also increase if there are a large number of selling shareholders because of the legal

and administrative work for each seller. In secondary or partial secondary offerings, some of the legal and other fees may be borne by the selling shareholders. Those shareholders and the company determine the allocation of those expenses. However, the company often bears many of the expenses (other than the underwriters' discount attributable to the selling shareholders' shares). In most cases, you will also pay a fee to the underwriters' counsel for work in connection with Blue Sky filings, when required, and FINRA clearance.

Accounting and audit fees. Audit fees are incurred for the audit of the financial statements, as well as the auditor's participation in the process associated with the preparation of the registration statement and the comfort letters for the underwriters (explained in Chapter 6). The fees will increase significantly if separate financial statement audits of businesses acquired or to be acquired, equity method investees, or financial guarantors are required. Also, if interim financial statements are required, the audit fees will be higher, as the auditors will need to review them, particularly in connection with the comfort letters requested by the underwriters. As noted above, situations could arise where there are multiple auditors involved in the various financial statements that are required to be included in the registration statement, which can further add to the audit fees incurred. In addition, your company may want your accounting advisers to perform an assessment of your company's current level of compliance in the areas of financial/SEC reporting, corporate governance, process, systems and controls, and tax with any regulatory or statutory requirements and best practices. This assessment is valuable, in that it helps to formulate your IPO timeline and could identify the presence of any issues that might otherwise fall through the cracks early on in the process.

Printer and printing costs. Your financial printer will charge you for the preparation and filing of the registration statement and the amendments thereto. You will also need to have the red herring and final prospectus printed by your financial printer. Printing costs vary depending on the length of the prospectus, artwork, and the extent of the revisions required. Significant savings may be realized by preparing preliminary drafts internally.

D&O liability insurance. D&O coverage relates to liability arising from alleged wrongdoing of directors and officers while acting on behalf of their company or organization. The cost of D&O liability insurance varies depending upon market conditions and the amount of coverage sought, and is critical in that it allows a company's directors and officers to make strategic decisions, in good faith, without the fear of personal liability. Such liabilities can result from lawsuits brought against a company's directors and officers by shareholders, customers, regulators, and even competitors. You should consult with your company's insurance agent to obtain an accurate quote on the cost of a D&O insurance policy.

Miscellaneous expenses. Other expenses include the SEC filing fee, the Nasdaq or NYSE listing fee, any Blue Sky notice and/or registration filing fees, and registrar and transfer agent fees. Each of these can range from several hundred to thousands of dollars. You will also need to include the cost of the roadshow and investor relations' expenses in your budget. You may also have fees of a compensation consultant or other consultant you may hire in connection with the IPO. In addition to these identifiable costs, significant executive and administrative time will be spent putting the offering together.

From a financial statement perspective, many of the costs associated with a successful offering can be offset against the proceeds from the offering on your balance

sheet rather than charged directly to the income statement. For instance, certain incremental costs incurred prior to the effective date of an offering may be deferred and charged against the gross proceeds of the offering. Management salaries or other general and administrative expenses may not be allocated as costs of the offering and therefore cannot be charged against the proceeds of the offering.

Deferred costs of an aborted offering may not be deferred and charged against proceeds of a subsequent offering and therefore must be written off. A short postponement (up to 90 days) does not constitute an aborted offering. Therefore, should you decide to withdraw your offering, you are required to write off the deferrable costs before any action to "start over" is initiated. However, if the offering is merely postponed, not withdrawn, and restarted within 90 days, then the deferred costs can be charged against the gross proceeds.

Future expenses. The future costs attributable to being a public company must also be taken into account. Making the transition to a public company will put a strain on the resources that your company currently has due to the additional responsibilities and requirements that are inherent for any public company. Additional executives may need to be recruited to help the CEO and the CFO run the company, and additional employees may need to be hired in the accounting, SEC reporting, and tax functions to handle the reporting requirements of a public company. In addition, the CEO and the CFO will need to file certifications as to the accuracy of the financial statements contained in the SEC filings. The company will need to maintain its ICFR, which may mean hiring additional employees or outside consultants. You may be required, on an annual basis, to have the company's auditor perform an engagement to attest to the effectiveness of the company's ICFR. See Chapter 9 for additional information.

Additional costs will be incurred in establishing an independent board, an audit committee, and other board committees. The company will be required to file current and periodic reports with the SEC that may involve legal, accounting, and printing costs. For example, companies incur costs associated with the printing and distribution of a glossy annual report as well as soliciting proxies for annual shareholder meetings. An ongoing investor relations and corporate communications program is also advisable. Executives will likely need to spend a significant amount of time on all of these matters.

Corporate governance

From a corporate governance perspective, preparations for an IPO are not only necessary but may be used as a tool for companies to focus on board structure and practices prior to being required to comply with regulatory standards. Regulatory requirements and stock exchange listing standards mandate that public company boards comply with a host of governance enhancements.

Board of directors

In the United States, every corporation has a board of directors. For a private company, the board typically is composed of company executives, shareholders, family members, and, in some cases, independent members. Conversely, the board of a public company typically is, and in most situations is required to be, composed of a majority of independent directors, within 12 months of the IPO. This is one of the many fundamental differences between a private and public company board.

The NYSE and Nasdaq have specific corporate governance listing standards. These rules are important to consider as companies evaluate their organization's corporate governance leading up to an IPO. Broadly, the governance listing standards of the exchanges address items such as the definition of independence, board

structure, use of executive sessions, committee composition, committee charter requirements, and so on. While these rules are prescriptive and you should consult with counsel to ensure compliance, this is an opportunity to optimize board structure, composition, and effectiveness by considering corporate governance in the early planning stages.

Well before the IPO, it may be beneficial to take a critical look at your board. In light of the necessity to comply with public company standards, composition will likely be one of the more significant areas requiring attention. Reviewing the existing skills and knowledge of the board and how they align with the strategic objectives of the organization, as well as the gaps that may occur as a result of shifting composition, may better position the board for day one of being a public company board.

Audit committee

Each public company is required to have an audit committee. The audit committee is established by and among the board of directors for the primary purpose of assisting the full board with its oversight responsibilities pertaining to the company's financial statements; its compliance with legal and regulatory requirements; and the company's independent auditor's qualifications, independence, and performance, among other things. The activities of the committee are required to be articulated in a publicly disclosed charter, the standards of which are defined by the applicable stock exchange.

Compensation committee and nominating/corporate governance committee

As part of an IPO, there are many compensation-related considerations, including:

- 1. Understanding the impact on executive roles and benchmark levels of compensation.
- 2. Establishing a peer group of similar companies and developing a plan to bring compensation in line with the market.
- 3. Implementing an Annual Incentive Plan and a Long-Term Incentive Plan.
- 4. Considering adoption of stock ownership guidelines, which require executives to own a predetermined number of shares of company stock, or value of shares, by a certain date (typically, five years) in order to align management's and shareholders' interests.

The two additional required board committees are the compensation committee and the nominating/corporate governance committee. For Nasdaq-listed companies, the function of the nominating committee may be performed by a majority of the independent directors of that company. The requirements for these committees are very similar in terms of presence and committee structure.

The role of the compensation committee is to set CEO compensation and approve appropriate and supportable pay programs, principally for executive officers, that are in

the company's best interests and aligned with its corporate mission, strategy, and risk profile. The nominating/corporate governance committee plays a critical role in overseeing matters of corporate governance for the board, including formulating and recommending governance principles and policies. As its name implies, this committee is charged with enhancing the quality of nominees to the board and ensuring the integrity of the nominating process. The SEC requires disclosure of the presence of a compensation committee and a separate nominating/corporate governance committee of the board.

The exchanges have listing standards relating to compensation committees. NYSE- and Nasdaq-listed companies are required to have a compensation committee composed only of independent directors.

Exemptions for controlled companies

The NYSE and Nasdaq provide exemptions to their listing standards for controlled companies. A controlled company is defined by both exchanges to mean a listed company of which more than 50 percent of the voting power for the election of directors is held by an individual, a group, or another company. A controlled company is exempt from various corporate governance requirements, including the requirements relating to the independence of board members, the compensation committee, and the nominating committee. While both the NYSE and Nasdaq generally maintain similar exemptions, the specifics vary and should be considered in the context of controlled companies.

SEC corporate governance disclosures

The SEC requires significant disclosure on corporate governance matters. Disclosures include information about board meeting attendance, if the board has a process to allow for direct shareholder communications, risks related to compensation structuring, and the board’s consideration of diversity in selecting board or committee members, among others. Companies are also required to disclose the board leadership structure, which includes discussion of whether the roles of CEO and chairman

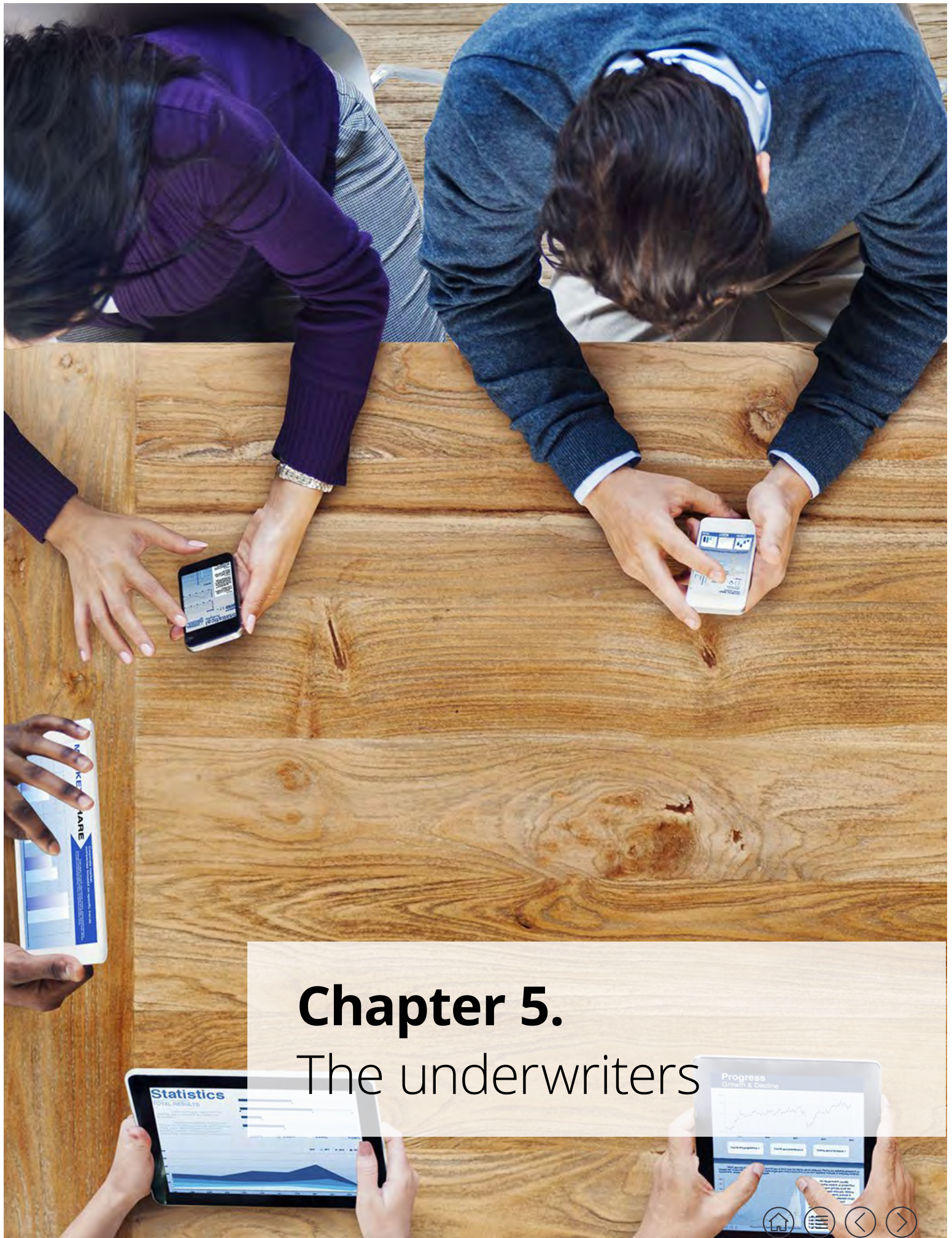
are combined or separate (and if there is a lead independent director). Also required are discussions of the board’s role with respect to risk oversight for the company.

The objective of the various disclosure requirements is to provide transparency to investors of the operations, structure, and policies of the board and its committees. For management and board members who have not previously been involved with a public company, these disclosures should be considered by the management team and board early in the IPO process.

Policies and committee charters

Companies will also want to consider their corporate governance policies and committee charters during the pre-filing period. It is important for companies to engage in dialogue with counsel in order to ensure that these documents contain all of the necessary and required duties and responsibilities for each committee. Each of these documents will need to be disclosed on the company’s website, so it is important that they are thoroughly vetted by all applicable parties and accurately articulate the full scope of the board’s and committees’ responsibilities.





Chapter 5.

The underwriters

Your primary goal when your company goes public is a successful offering.

A successful offering not only brings a fair price for your stock but also leads to a stable or rising price for the stock after the IPO. While there is nothing to prevent you from conducting your own initial public offering, the use of underwriters can help ensure that the offering is successful.

If you were to conduct your own offering, you would probably find it very difficult to find a sufficient number of buyers for your stock, and you could encounter challenges in determining the right price for your stock. Key reasons for using underwriters are that they can market your shares to a broad base of institutional and retail investors with whom they have relationships, help you craft your company's story, and guide you to the appropriate valuation for your shares.

Underwriters are also familiar with market conditions; they can gauge the level of interest of institutional and individual investors regarding new stock issuances and are familiar with the valuation of similar companies. They are typically in the best position to advise you on what price to ask for your stock, as well as on when to sell it. Their sponsorship usually continues well past the IPO and may affect the way your stock performs in the aftermarket.

Selecting underwriters

A group, or syndicate, of underwriters normally conducts IPOs. Your company first needs to select the lead underwriter (or underwriters), which will lead this syndicate.

Underwriters come with various backgrounds and have differing preferences for the kinds of companies they want to support. Some are national firms that seek out companies with national reputations and established growth records. Others are regional firms that focus on companies from their geographic area or specialize in certain industries, such as health care or financial institutions.

Ideally, you will have already developed a relationship with investment bankers by the time you decide to go public. Most companies approach an investment

banker (or vice versa) at least a year or two in advance. Some startup companies make this connection during early-stage private placements. In doing so, they avail themselves of the investment bankers' advice on positioning their companies to go public.

Investment bankers may assist in arranging financing in those years, keeping you informed of current and predicted general market conditions and the mood of the market with regard to your industry, and advising you on the appropriate time to go public. Before selecting underwriters, the company should evaluate the prospective underwriter's selling, distribution, and research capabilities. Do the underwriters have a history of effectively selling IPOs? Do they have a strong sales force and relationships with key investors in the company's sector, as well as a strong retail network? In addition, you should meet the investment banks' research analysts and be comfortable that they "get" your story. The research they write post-IPO will be an important determinant of market interest in your stock.

If you do not already have investment banking relationships, there are many things to consider when establishing one. It is important to keep in mind that your relationship with your investment banking firm will likely not end when your IPO is completed. Because it may be an ongoing relationship, you should make your choice with all the care you exercise in selecting your auditor, accounting advisers, attorneys, and the other professionals with whom you regularly work.

Investment bankers, unlike other professionals, do not typically charge hourly rates for their services. They are compensated through fees or commissions

on any completed deals they underwrite or advise on for you. These commissions do not usually vary significantly from firm to firm, so pick from the best firms available and have an understanding of market rates for offerings of the size and nature you are contemplating.

An effective way to consider which investment bankers you may wish to approach is through a mutual contact (your directors, investors, accounting advisers, or attorneys may be able to assist you).

Be prepared to shop around and compare firms. If your company has promise and the investment bankers know you are talking to other firms, they may show greater interest and be more competitive. Many companies ask a number of bankers to formally present or pitch their credentials to them (sometimes referred to as a “bake-off” or “beauty contest”). Here are some characteristics to look for in investment bankers:

Reputation

In an IPO, the underwriters’ reputation is of great importance. Institutional and individual investors may have greater confidence in your stock if a highly regarded investment banking firm is named in your prospectus as a lead underwriter. Reputation can also affect the ability to organize a strong syndicate of other underwriters to assist in selling and distributing the stock.

Distribution capability

You will want the underwriters to distribute your stock to an investor base that is sufficiently strong and varied to generate ongoing market interest in the stock after the IPO. An investor base of committed, long-term holders will help avoid excessive churn in your shares in the aftermarket. Investment banking firms have wide client bases. You should understand the composition of the client base and evaluate it in the context of your strategy.

Some firms have access to many institutional investors, while others emphasize individual or “retail” investors. Some have an international emphasis, while others are domestically oriented. Evaluate the quality of their investor relationships, whether they are long-term investors or speculators. Mutual fund companies tend to be longer-term holders, while hedge funds are more varied with some “long only” funds considered to be good longer-term shareholders, whereas others may be more likely to trade your stock for more speculative gains. You should always ask any proposed lead underwriters what the aftermarket performances of their IPOs have been in the recent past.

Calendar

You should ask any prospective lead underwriters what other offerings are on their “calendar” of transactions. These other offerings may be competing with your IPO for attention from the people at the lead underwriters responsible for the actual allocation and placement of your shares, or the lead underwriters may try to sequence other offerings ahead of yours, causing you to miss optimal execution windows. It is extremely important that your offering receive sufficient attention throughout the process and particularly during the last week or two prior to the pricing of your transaction when you are marketing your shares.

Experience

The investment banking firms should typically have experience in underwriting issues of companies in the same or similar industries. This may influence their ability to help you craft your equity story to appeal to investors and to price the issue accurately and may give them improved credibility when explaining and selling the company to the public. Experience of the investment banking firms is key—while there are many investment banks with excellent reputations, you should consider their experience with IPOs in your company’s industry and key investor markets before making a selection.

Market-making capability

Once the stock has been issued to the public, the lead underwriters generally assume responsibility for continued sponsorship of your company in the financial community. This sponsorship includes “making a market” in the company’s stock and assisting the company in sustaining public interest in the stock, including organizing presentations to investor groups. Other members of the syndicate may become market makers as well. The market makers of the stock trade in your stock, offering firm prices to buy or sell shares. The lead underwriter often serves as the principal market maker. In order to maintain a market, the lead underwriter may need to devote a sufficient amount of capital to take positions (i.e., short or long) in your stock. Without this support, large shareholders may not have sufficient liquidity, interest may wane, and the market price of your stock may suffer. When you consider the aftermarket performance of proposed lead underwriters, you are often assessing its willingness to place its capital at risk for its company clients.

Research analysts

The financial community will look to the lead underwriters as a primary source of information about your company.

Therefore, the selected investment banking firms should have experienced research analysts who are respected by the financial community and closely follow the industry in which the company does business.

Certain conflict of interest rules between research analysts and their investment banking firms were designed to promote independence and objectivity of research reports. The rules restrict analyst participation in certain activities and also prohibit certain communications by analysts and between analysts and investment bankers.

There are provisions for EGCs that are designed to liberalize the communications

and interactions of analysts in the IPO process and increase the flexibility regarding publication and dissemination of research reports about EGCs.

Notably, brokers or dealers that are participating in the registered offering of an EGC may publish research reports about the EGC, and may publish or distribute research reports or make a public appearance with respect to the securities of an EGC during post-IPO quiet and lock-up periods. In practice, however, most banks continue to impose customary research blackouts on offerings by EGCs through the 25-day prospectus delivery period following an IPO.

Ability to provide financial advice

During and after your IPO, you will look to your investment bankers for financial advice. You may need help in obtaining additional funding in the future, advice on potential mergers and acquisitions, or insight into the investing public's attitude toward your company.

Other considerations

You should talk with the proposed investment bankers' other corporate clients to find out firsthand what their experience has been and how they feel about their relationship with the underwriter. You should ask both about working with the underwriter during the offering and how supportive the underwriter has been after the offering. Read the prospectuses of other IPOs in which the investment bank has acted as a lead underwriter.

You should also take the time to be sure you are comfortable not only with the people with whom you will be initially directly involved but also with those who will have ongoing responsibility for market making, research, and sales sponsorship. The personal chemistry between your investment bankers and you, your management team, and your board is extremely important. Many companies

use more than one lead underwriter. Most companies also choose to use other underwriting firms to act as "passive" bookrunners or as co-managers of their offerings if they have a good relationship with more than one firm or if the company sees advantages to combining the client bases, research capability, geographic strengths, and other resources of the underwriting syndicate. It is important to keep in mind that there may be certain conflicts of interest between you and the underwriters, such as conflicts that may arise because of their long-standing relationships with institutional customers or with some of your competitors. Underwriters receive their commission if the transaction is completed, whether successful or not in the aftermarket.

What underwriters look for

Before any underwriters agree to proceed with your IPO, they will want to investigate your company to decide whether they want to take your company public. This investigation constitutes a portion of their due diligence. They will also do specific due diligence on the company and registration statement disclosure later in the process. Assuming they decide to back your company, the information they gather during their investigation will also assist them in determining how to price the stock. The underwriters will closely investigate many of the items described in Chapter 2, including management quality, employees, product quality and industry potential, strength of customer and supplier relationships, financial and tax positions, key performance indicators, financial performance history and projected growth, and company reputation.

The underwriters' investigation can take several weeks or more depending on their familiarity with your company and your industry. They and their legal advisers will review legal, accounting, finance, and tax materials. They will also interview your key executives, and they will talk to people

outside the company, including customers, suppliers, competitors, and other people who are knowledgeable about your industry.

A detailed presentation of the company is extremely helpful in providing information about your company to the underwriters.

This presentation should include a realistic portrayal of your company's operations, strengths, and risks and of the projected application of an offering's proceeds. A well-done presentation also provides a great deal of information that will be useful when drafting the registration statement. A detailed and thorough business presentation can reduce the time and expenses incurred by attorneys and other professional advisers.

Remember that even if the underwriters complete this initial investigation to their satisfaction, they will have no legal commitment to take you public until the completion of the marketing and pricing of the transaction, which is one of the last steps in the IPO process.

The underwriters will also evaluate factors related to the offering itself in determining whether to take you public. These include:

Use of proceeds. The underwriters will evaluate how much money you will need to effectively operate and grow the company under your business plan. If you require more money than can realistically be raised in the public market at the time, it may not be wise to try to go public now. If a large amount of the proceeds will go to shareholders or if key employees are selling stock, the underwriters may want some assurance that these people are not selling because they have lost confidence in the company.

Marketability. The underwriters will also consider the state of the markets at the time, both generally and for a company

in your industry and at your stage of development. These things can change quickly, so you must be prepared to be flexible in this process.

Selecting a trading market

Working with your lead underwriters and legal counsel, you should consider on what trading market you want your stock to trade after the IPO. The initial listing requirements of the NYSE and Nasdaq are detailed in Appendix C: The securities exchanges. In addition, both the NYSE and Nasdaq have corporate governance requirements for their listed companies. See “Corporate governance” in Chapter 4 for a general overview.

Types of underwriting

There are generally two main types of underwriting:

A firm commitment. Under this arrangement, the underwriters agree to buy all the stock being offered at a fixed price, usually determined on the date the registration statement becomes effective. They then resell the stock to the public, consisting largely of the investors the company will have met with on the IPO roadshow.

A best-efforts commitment. Essentially, the underwriters agree to use their “best efforts” to sell the new issue on your behalf. If they do not sell the entire amount to the public, they have no obligation to purchase the balance. Thus, they are acting merely as your agent. These are rare in IPOs and are practically impossible to do in any offering that will be listed on an exchange.

The firm commitment is generally the preferred—and by far the most common—form of underwriting arrangement, as it ensures you that your company will receive a certain sum of money by a certain date. It also facilitates listing on an exchange because the lead underwriter makes a representation to the exchange as to the

distribution of the offering. The type of underwriting that is offered to you will depend on the underwriting firm that you are using and the nature of your stock offering. If one of the major firms agrees to underwrite you, it will almost always agree to a firm commitment. The smaller firms that handle more speculative offerings may do so on a best-efforts basis.

Pricing the stock

As in most pricing situations, no set formula exists for determining the proper price for a company’s stock. The pricing for an IPO is determined by a combination of factors. Your investment bankers will examine the enterprise value of companies that operate in your field or have similar business models and profiles, particularly publicly traded peers. If none exist, the underwriters will then try to find other companies in related areas or with related growth and other attributes.

They will typically select the most relevant of these companies based on similarity of the companies’ business products, financial and growth profiles, scale, consumers and end-markets, or other factors to form a comparable set (often referred to as “comps”). They will examine factors such as price-earnings ratios, forward revenue or earnings before interest, taxes, depreciation, and amortization (EBITDA) multiples, capital structure, debt-to-equity ratios, return on assets, and return on sales of these companies. They will weigh carefully your prospective revenues, earnings, and any potential dividends; the amount of stock that will be available; and the potential demand. Investors will often expect the company to be valued at a discount to these publicly traded, comparable companies; therefore, selection of the right comp set is of paramount importance. Bankers will also often perform other valuation work as a “check” on their comparable company analysis, such as a discounted cash-flow analysis.

If possible, it will be useful for you to perform this analysis on other companies prior to meeting with underwriters on price. It is a good idea to develop a valuation model well in advance of the IPO (e.g., more than one year in advance) and use this information to refine the business model to maximize the long-term valuation. In addition, this valuation model may be useful in pricing employee stock options. Many companies also engage outside valuation experts to prepare periodic valuation reports for purposes of pricing their stock options.

There is usually a good deal of information available about companies similar to yours to help you develop a range for the price of your stock. This analysis will help you negotiate realistically with the underwriters. If your company is selling stock to the public for the first time, pricing is different than for a company that has its stock listed on an exchange already. Cautious buyers may want to wait and see how your company’s stock behaves before they purchase it, reducing demand in the offering, or they may demand steep discounts to publicly traded peers.

It is also possible that, although your company is not well known in comparison with others in your industry, your growth patterns and potential are so attractive that the public will accept a greater multiple for your company’s stock than for others that are more seasoned. The price for the offering will depend, in part, on the demand for the stock during the marketing period, as evidenced in the bookbuilding process that the lead underwriter has conducted. If demand has been particularly high from attractive potential investors, it may be possible for the company to increase the size of the offering or the expected price, or both. Alternatively, if the market has weakened or demand is not as high as expected, the expected price or size of the offering may have to be reduced.

It is not necessarily advantageous for your stock to be sold for the highest possible price that underwriters could achieve. If the IPO price is set too high in relation to the company's peers, given prevailing market conditions, the aftermarket may be weak. Consequently, underwriters usually advise you to sell slightly below (traditionally between 10 and 15 percent) the anticipated aftermarket price.

Sometimes, a stock's price will increase sharply immediately after the IPO. This does not necessarily mean that the stock was priced incorrectly. Underwriters try to establish a price under normal trading conditions. Sometimes, though, surprises occur. There have been instances where the trading price has doubled or tripled in the first few days or weeks of trading.

Direct listing is an alternative that has been utilized recently in select circumstances for companies seeking to go public. Direct listings do not rely on the bookbuilding process described above to set a price or identify investors and may be appropriate for private companies that are not seeking additional funding, but whose shareholders want the flexibility to sell their shares on the open market. In a direct listing, pricing is determined after the company provides information about itself to the general public and works with the applicable stock exchange to set an opening price.

Direct listings are generally less expensive than IPOs, since they need not involve an underwriter or significant underwriter fees. However, because an underwriter does not agree to buy all the shares offered or agree to provide any post-offer pricing support, the valuation of the stock may not be as strong and the post-listing trading price may be more subject to volatility.

Size of the offering

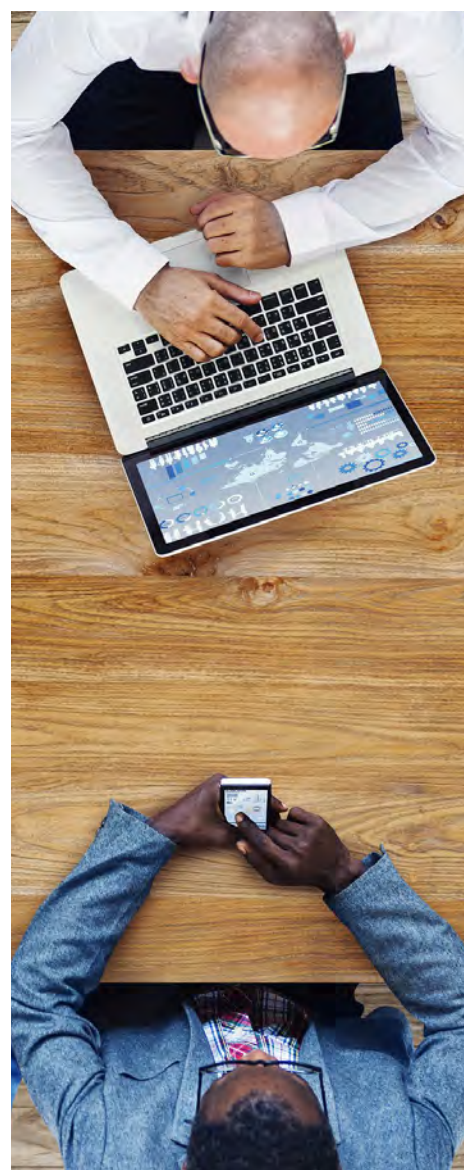
Determining the appropriate offering size is important, as it may affect the company's engagement of an investment bank and the ability to attract high-quality investors. If the offering is not large enough, many institutional investors will be hesitant to invest due to the potential lack of liquidity in the aftermarket.

Sometimes, a public company will decide that it does not need that much money, or any at all. A partial, or total, secondary offering, in which the existing shareholders sell some of their shares, may be made to obtain the desired number of shares to be sold.

In some cases, early-stage companies are not encouraged to make secondary offerings of any significance. If these companies want other people to invest in them, the existing shareholders must show confidence in the potential of the stock. Underwriters may become concerned if they see investors who may have held stock for only a short time and already want to sell. Conversely, for later-stage companies, particularly those in which private equity sponsors have held positions for a longer period, meaningful secondary sales are generally more acceptable. As for management and key directors, sales are generally discouraged in IPOs, although in some cases, sales of less than 10 percent of any one individual's stock may be acceptable. Of course, the underwriters may make exceptions if there are valid reasons.

The number of shares sold is a function of price and total valuation of the company. Issuing too many or too few shares can unfavorably alter the share price and thus the total amount to be raised in the offering.

Keep in mind that underwriters have some flexibility on this matter at the time of the offering, as they are generally allowed to offer and sell up to 15 percent more shares than set forth on the cover page of the prospectus for the offering. This option, which is agreed upon in the underwriting agreement, is referred to as the over-allotment option in an IPO, also known as a "green shoe," and is described in more detail in Chapter 9.





Chapter 6.

Registration

The entire IPO process revolves around your company's registration with the SEC.

Registration is achieved through the filing of a legal document referred to as the registration statement, and the contents of this document are governed by the securities laws and rules thereunder. Preparing the registration statement can be a lengthy process even if everything goes smoothly. It is not uncommon for completion (including review and comment period) of the registration statement to take three or four months or even longer. The company is strictly liable for the information in the registration statement, and great care must be taken in its preparation. Because directors and officers who sign the registration statement also may have liability for misstatements or omissions in the registration statement and prospectus, they are responsible for ensuring the accuracy of the information included in the registration statement.

During the preparation phase, one or a series of planning and review meetings are held, often referred to as “all hands” or “organizational” meeting(s). Meeting participants generally include company officials, counsel, underwriters and their counsel, as well as the company's external auditors and other advisers.

The purpose of the organizational meeting is to establish an initial timetable; assign responsibilities; discuss the components of the registration statement; present business, financial, and legal information; and assess other aspects of the offering. An illustrative timetable is available in Appendix D: A timetable for going public.

When an initial draft of the registration statement is complete, it may be confidentially submitted to, or publicly filed with, the SEC. Issuers must publicly file their registration statements at least 15 days prior to commencement of the IPO roadshow. The registration statement is then reviewed by the SEC in order to determine if it complies with the applicable disclosure and accounting requirements. The SEC will then issue a comment letter on the registration statement requesting clarifications, modifications, and other information approximately 30 days after submission or filing. The company formally responds to the comments by letter, modifies the registration statement, and files, or submits, an amended version. This process continues until the SEC is satisfied with the disclosure. The SEC staff has issued guides designed to assist potential registrants, such as the Division of Corporation Finance's *Financial Reporting Manual*, as well as “Staff Observations in the Review of Smaller Reporting Company IPOs,” which may be helpful when preparing the initial registration statement.

The interval between the initial filing or submission of the registration statement and its effective date is traditionally known as the “quiet period” or “waiting period.”

Typically, after several rounds of comments, the “preliminary prospectus” is filed and printed for use in the marketing efforts. The preliminary prospectus must bear a legend stating that a registration statement related to the offering has been filed with the SEC but has not yet become effective, and that the securities may not be sold, nor may offers to buy be accepted before the effective date. Because this legend is printed in red ink, the preliminary prospectus is commonly referred to as the “red herring.” The red herring is typically printed and distributed to potential investors after the company and its advisers resolve all potentially significant SEC comments. The red herring also includes the number of shares to be offered and an estimated pricing range for the shares.

The merits of your offering may need to be reviewed and approved by the states in which the stock is to be sold, and the underwriters' compensation must be reviewed by FINRA. Once these requirements are addressed and marketing efforts are completed, the registration statement can be declared effective, the pricing of the offering can occur, the securities may be sold, and a final prospectus can be printed. There is also an accompanying registration of the class of stock being sold under the 1934 Act. This concise registration document incorporates portions of the 1933 Act registration statement. See the discussion of the 1934 Act in Chapter 9.

If your financial statements have been audited on a regular basis in the years leading up to the filing of a registration statement, ensuring that the financial statements are SEC compliant may be less difficult.

Who does what

The better prepared the company and its executives are to complete the registration statement, the more efficient the external professionals can be. While each party has specific responsibilities, the entire group must be comfortable with the final product. Everyone is associated with the registration statement in some way, and it is in everyone's interest that the registration statement is accurate and complete. Here are the basic expectations for each party:

Company management

The most important team members are the company's management, typically led by the CEO and the CFO. Your management team acts as a liaison between the working group and the company's board and plays a critical role in all aspects of the IPO process. The management team will make structural and timing decisions relevant to the IPO with advice from underwriters and counsel and, with assistance from the company's advisers, will prepare the registration statement, respond to SEC comments, and prepare and deliver the roadshow presentation.

The best way for executives to expedite the process is to have a detailed and up-to-date business plan and projections ready for outside professionals to use as a reference. The plan normally includes the company's future objectives, as well

as analyses of the company's place in its industry, details about its market, an assessment of the competition, a complete description of its products or services, and consideration of risks to the company's performance. Along with this, the company should prepare a detailed financial model on which its advisers will perform due diligence thoroughly, which will form the basis of projections that will ultimately be shared with the research analysts in the syndicate ahead of the IPO. Your CEO and CFO must also be ready to certify the accuracy of the historical financial statements and disclosures as part of the annual reporting process.

Company counsel

As the registration statement is, in large measure, a legal document, the attorneys generally take a leading role in drafting the majority of it. The company's management will gather information and answer questions as needed. Based on the information gathered by management, counsel will be able to assist you in deciding which particulars should be included in the registration statement (i.e., what facts are material) and how they should be included. In addition, counsel will coordinate and assist in the drafting of responses to the SEC comments. The company's counsel is also responsible for helping you with pre-IPO corporate housekeeping and IPO preparations, coordination of the due diligence process, negotiation of the underwriting agreement on behalf of the company, securities-related matters, and issuance of a legal opinion on the validity of the securities being offered and the accuracy of the disclosure, among other things. Choosing the right counsel is imperative. Similar to your investment banking advisers, you will develop a close relationship with your counsel, and establishing a relationship of trust is critical. Moreover, you will want to choose counsel with significant experience with the IPO process and with a deep bench

to advise you on the many issues that will arise throughout the process (such as tax, corporate governance, and executive and share-based compensation plans, among many others).

Auditors

The company's auditor must audit the financial statements included within the registration statement and issue a report on the audit regarding whether the financial statements present fairly, in all material respects, the financial position of the entity as of the balance-sheet date and the results of its operations and its cash flows for the period then ended, in conformity with generally accepted accounting principles (GAAP). If your financial statements have been audited under PCAOB standards on a regular basis in the years leading up to the filing of a registration statement, ensuring that the financial statements are in SEC-required form may be less difficult. Your auditors will also perform reviews of your quarterly financial statements, which may be included in the registration statement.

Subsequent to registration, your auditor may be required to issue an opinion on the company's ICFR. See Chapter 9 for additional information. In conjunction with preparation of the registration statement, your auditor will also review drafts of the registration statement for accuracy and consistency of financial information. Your auditor may also assist in the resolution of accounting and financial reporting questions raised by the SEC during the SEC review process and will issue "comfort letters" to the underwriters and company's board of directors as part of their due diligence process.

Advisory

An accounting adviser, not restricted by the independence standards of auditors, can provide assistance to management with SEC reporting requirements, updating financial reporting for SEC compliance, preparation of MD&A and pro formas as necessary, and

evaluation of new and revised accounting policies; review of the draft prospectus; and responses to SEC comment letters. The accounting adviser can also assist you with post-IPO issues involving information systems, internal controls, SEC reporting, business process improvements, and corporate governance.

Underwriters

The lead underwriter or underwriters will manage an underwriting syndicate to provide you with advice on the pricing, timing, and distribution of the issue. In addition, the lead underwriters will organize the roadshow to help promote the securities and increase demand for the offering. Underwriters are also active participants in the drafting process, particularly with respect to the summary section of the prospectus (otherwise known as the “box”), and the description of the company’s business and the industry in which the company operates, as well as in responding to SEC comments. Underwriters typically have a depth of experience both in the issuer’s industry and in marketing IPOs and other transactions and can help the company craft an equity story that resonates with investors. Your underwriters can also supply you with examples of registration statements from similarly situated companies, which can be extremely useful guides in drafting your registration statement and creating a marketing strategy for the offering.

Underwriters’ counsel

One of the principal roles of underwriters’ counsel is to confirm that the registration statement is complete and not misleading. To do so, the underwriters’ counsel will participate in drafting the registration statement, conduct due diligence meetings, draft the underwriting agreement, request comfort letters from your auditors, help respond to comments from the SEC, and be responsible for clearing the offering with FINRA.

Pre-filing activities

Due diligence

Due diligence is the process of ensuring that the information in the registration statement is accurate in all material respects and that the registration statement does not contain any untrue statements of material fact or omit material facts required to be stated in the registration statement or that are necessary to prevent statements in the registration statement from being misleading. One component of due diligence includes questioning key management personnel about company activities, matters disclosed in the prospectus, and matters not disclosed in the prospectus. It is also common for underwriters to conduct third-party background checks on the company’s management team and its directors.

Under the 1933 Act, securities fraud liability may be incurred if a registration statement contains misstatements of material facts or omissions of material facts. The company, its directors, the officers who sign the registration statement (the principal executive, financial, and accounting officers), the underwriters, and any experts (such as auditors) participating in the registration may all be potentially liable. The company itself is liable for any material deficiencies, regardless of good faith or the exercise of due diligence. This requires that a complete due diligence process be performed, which greatly increases the length of the preparation phase.

Corporate documents and related information

Your counsel and the underwriters’ counsel will review articles of incorporation, bylaws, minutes of board and committee meetings, major contracts, employment agreements, stock option plans and related valuation materials, and other significant company documents to verify that the prospectus disclosures are complete and accurate. Questionnaires are circulated to all directors and officers requesting certain information, including their names, prior experience, direct and other remuneration, options,

warrants and rights, transactions with the company, indemnification agreements, and the number of shares owned of record and beneficially (shares in which they, directly or indirectly, have or share voting or investment power). In some cases, the individual directors and officers may be interviewed by your advisers.

Financial statements

The company’s audited financial statements will be included in the prospectus, with reliance on the auditor’s report given on the authority of the auditors as experts in auditing and accounting. In order for a company to include the audit firm’s report in the filing and to refer to the firm as experts, the company must request and obtain the auditor’s consent to the inclusion of their report in the prospectus and to being named as experts. Before these consents are given, the auditors must perform a reasonable investigation through the filing dates, conducting a subsequent-events investigation to determine whether the financial statements and their opinion thereon are still appropriate.

This investigation includes inquiries into any events that occurred or became known after the date of the auditor’s last report, which, had they been known at the time, would have been disclosed or reflected in the financial statements. Your auditors will also review and discuss with management any concerns they may have with any interim, unaudited financial statements included in the prospectus. They will also read the entire registration statement for inconsistencies between the financial and nonfinancial portions and any material matters that have not been disclosed. The auditors are also asked by the underwriters to “provide comfort” (as explained below) on certain financial information disclosed in the registration statement (outside of the audited financial statements).

Comfort letters

During the registration process, the underwriters and their counsel will review

the financial statements with your auditor and reach an agreement regarding comfort letters. In requesting these comfort letters from the auditor, the underwriters are seeking assistance in performing a “reasonable investigation” of financial and accounting data in the prospectus that is not covered by the auditor’s report. Two comfort letters are generally issued: one on the effective date of the registration statement and one on the closing date, the latter of which is often referred to as the “bring down” comfort letter. The comfort letters list specific procedures performed at the request of the underwriters. The underwriters will request that your auditor furnish a preliminary draft well in advance of the first due date so that the underwriters may decide whether the procedures described in the letter are consistent with what they requested. The procedures, performed by the auditor, usually include a comparison of financial data (contained throughout the prospectus) to accounting records or financial statements. They also include consideration of financial results available subsequent to the last audit or interim financial information included in the prospectus for purposes of determining whether there have been any declines in sales or income or other trends that are not adequately disclosed in the document. It is important for the company to be involved in the procedures requested by the underwriters early in the process, as management may be able to identify items that can be resolved with the underwriters in advance of the issuance date. The company may choose to discuss these situations with the underwriter prior to the issuance date of the comfort letter to avoid surprises or potential delays in filing. For example, sales for the most recent month may have declined from sales for the same month a year ago, and this decline will be noted in the comfort letter.

Types of issuers

Issuers may be domestic issuers or foreign private issuers (FPIs). Domestic issuers (which are the primary focus of this publication) are generally organized under the laws of a state of the United States of America. FPIs are incorporated or organized outside the United States but register securities to be sold in the United States. The SEC offers certain financial statement and disclosure accommodations for FPIs. Chapter 10 defines foreign private issuers and summarizes some of the more important accommodations.

The SEC also created a designation for “smaller reporting companies” to streamline and simplify the disclosure for companies with smaller market capitalizations. The primary determining factor for eligibility as a “smaller reporting company” is that the company has less than \$250 million in public float as of the last business day of its most recently completed second fiscal quarter or annual revenues of less than \$100 million and no public float, or a public float of less than \$700 million.

Domestic issuers and FPIs may qualify as EGCs. An EGC is defined as a company with total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year. An EGC will continue to be an EGC until the earliest of: the last day of the fiscal year during which it had total annual gross revenues of at least \$1.07 billion; the last day of the fiscal year following the fifth anniversary of the IPO of its equity; the date on which it has, during the previous three-year period, issued more than \$1 billion in nonconvertible debt; or the date on which it is considered to be a “large accelerated filer” under the 1934 Act. Appendix F outlines the benefits of EGC status, including reduced financial statement requirements and delayed implementation of certain regulatory and accounting requirements.

You should consult with your legal counsel to determine if your company may qualify as a smaller reporting company, EGC, or FPI.

The registration statement

Most registration statements for IPOs of domestic issuers are prepared on Form S-1. As indicated, however, there are scaled disclosure requirements for smaller reporting companies and EGCs.

The registration statement consists of two principal parts. Part I contains the prospectus, which is a legal offering document that will be distributed to prospective buyers. The prospectus also serves as a marketing document for the IPO. Part II contains other detailed information. The following discussion focuses on the Form S-1 registration statement. You should consult with your legal counsel regarding the specific requirements of each part of the registration form.

Part I: The prospectus

The registration forms contain a series of detailed “items” and instructions, in response to which disclosures must be made. Because the prospectus is the selling document as well as the legal document, it is usually written in narrative form and is highly stylized. The SEC requires the use of “plain English” for parts of the document (the cover page, summary, and risk factors sections) and encourages such for the whole document. The plain English rules require the use of short sentences that avoid technical and legal jargon. The SEC also emphasizes the necessity of carefully organizing information in the prospectus in a logical sequence and presenting that information in an understandable and balanced manner.

The prospectus serves two potentially conflicting purposes. On the one hand, as the basic selling document, the underwriters and company want it to present the best possible image of the company. On the other

hand, to protect the company, controlling persons, directors and officers, and underwriters from potential liability under the 1933 Act, it should not be written with the flair and style of marketing literature. Its emphasis should be on complete and accurate disclosure, and while the company will highlight the positive aspects of the company, negative aspects will also be addressed. Reading prospectuses of other companies in your industry will help you be prepared for drafting your company's prospectus, especially with regard to the level of detail required when preparing your company's description of business and MD&A, as well as identifying potential weaknesses and risks associated with your company. Note that most investors are accustomed to reading prospectuses and understand that they are not exclusively sales pitches.

Reading prospectuses of other companies in your industry will help you prepare for drafting your own company's prospectus, especially with regard to the level of detail required.

In practice, the information in the registration statement is generally presented in the following order:

Prospectus cover page. The outside front cover of the prospectus provides key facts about the offering, including the name of the registrant, the names of the underwriters, the date of the prospectus, the title and number of shares to be sold, a distribution table (the price to the public, the underwriters' discount, net proceeds to the company, and net proceeds to any selling shareholders on per-share and aggregate

bases). At the time of the red herring, the cover page will include a range of per-share prices (e.g., "It is currently estimated that the initial public offering price will be between \$12 and \$14 per share."), and the distribution table will be blank. The inside front or outside back cover includes a table of contents and information regarding the distribution of the prospectus. Many issuers include a glossy inside cover page or pages depicting images of the company's products or other graphical marketing displays. The SEC will scrutinize this content to ensure consistency with the prospectus and a fair and balanced presentation.

Prospectus summary. This section of the prospectus, typically referred to as the "box," highlights the prominent features of the offering and includes summary descriptions of the company's business and industry, the company's strengths and strategies, the offering, the use of proceeds, and the risk factors. An introductory statement about the company is generally given, explaining what business it is in, its main products or services, when it was formed, and where it is located. The summary will also disclose condensed financial and, if applicable, pro forma information. As it will often serve as the basis for a potential investor's decision to consider the stock further, the summary may require considerable time to prepare.

Risk factors. The prospectus includes a discussion of the most significant factors that make the offering speculative or risky. These may include such things as a lack of operating history, an accumulated deficit, operating losses in recent periods, an expectation of future losses, industry-related risk factors, uncertainty of market acceptance of the product, exposure to macroeconomic factors, dependence on key personnel or certain customers or suppliers, competition, and history of material weaknesses, among others. Other factors include risks related to first-time offerings; the potential impact of current or proposed

legislation; the company's dependence on strategic relationships or alliances; integration of acquired businesses; the need to expand parts of the organization, such as sales, support, or production; intellectual property risks; litigation and regulatory risks; cybersecurity risks; and any relevant and material technological issues. The issuer also should highlight other risk factors relating to the company and its operations. As other portions of the prospectus are written, be alert for issues that should be highlighted in this section.

Use of proceeds. This section explains how funds raised in the offering (assuming the offering includes a sale of primary shares) will be spent, such as to reduce debt, acquire a new business, or invest in the growth of the business, and must be carefully drafted. It will specify that any shares sold by selling shareholders will not result in proceeds to the company and will explain who is responsible for paying offering expenses and underwriting discounts and commissions.

Dividend policy. The company's dividend policy and any restrictions on future dividends should be explained. Note that many companies have never paid dividends, retaining all earnings to finance continuing operations and expansion. Any intent to not pay dividends in the near future must be disclosed as well.

Capitalization. This section contains a table exhibiting the capital structure (debt and equity) of the company before and after giving effect to the offering (i.e., on a pro forma basis).

Dilution. When substantial disparity exists among the effective IPO price, the book value, and the price that was paid for existing shares owned by officers, directors, and major shareholders, the resulting dilution of the purchaser's equity interest is shown. Tables will compare the price

paid by new investors with that paid by existing investors, and the net tangible book value of the stock with the price paid by new investors.

Selected financial data. This section includes certain selected financial data for each of the last five fiscal years or from the date of the company's inception, if shorter, and any interim periods that are included in the financial statements. An EGC is allowed to reduce the number of periods presented in selected financial data to a minimum of two years corresponding to the earliest period of audited financial statements included in the registration statement. The purpose is to highlight certain significant trends in the company's financial condition and its operations. Consequently, the data generally includes revenues; expenses, income (loss) from continuing operations, in total and per share (in practice, many companies disclose most of the details contained in their statements of operations); total assets; long-term obligations (e.g., debt, capital leases) and redeemable preferred stock; shareholders' equity; and cash dividends declared per share. A company may also include additional items that it believes would enhance an understanding of and highlight other trends in its financial condition and results of operations. This may include non-GAAP items, such as EBITDA, adjusted EBITDA, adjusted net income, or other metrics the company uses to assess its business. These items must be reconciled to their nearest GAAP equivalent, and the company must provide an explanation as to why it considers these measures important to investors.

There is no requirement for a smaller reporting company to present selected financial data, although the underwriters may request this information to be presented.

Selected quarterly financial data. There is no requirement to provide selected quarterly financial data within an IPO registration statement. However, the underwriters may ask for quarterly financial data to provide more information to potential investors, such as highlighting quarterly or seasonal variations in the company's business. You should discuss this with your underwriters early in the process, as the accumulation of this data may be time-consuming. If included, your auditors would be required to perform a review of this information. After the initial registration statement is declared effective, the company must be prepared to include selected quarterly financial data in subsequent filings with the SEC.

MD&A. The purpose of the MD&A is to provide management's view of current performance and expectations of the future and to enhance disclosure, quality, and variability of earnings and cash flows.

Management should provide a balanced explanation of the company's operations, historical results, and financial condition, and highlight both positive and negative trends that may reasonably affect the company's future. Management should also disclose critical accounting policies and significant estimates made; any trends, commitments, or events that may affect working capital and commitments for capital expenditures; and the source of funds for those expenditures. Significant changes from year to year in line items on the income statement should be explained, and significant related-party transactions should be discussed. Anticipated liquidity and capital resource issues should be highlighted, including future material capital expenditures, significant payments due on obligations, discretionary payments, acquisitions requiring cash financing, and other commitments. Any identified material deficiency in short- or long-term liquidity,

as well as the proposed remedy or the fact that the deficiency has not been remedied, should be disclosed. Off-balance-sheet arrangements that have, or are reasonably likely to have, a current or future effect on various aspects of the business should also be disclosed. Contractual obligations should be shown in a table showing future payments for certain contractual commitments, such as operating or capital lease obligations or debt obligations. Given the amount and varied nature of the information that is required to be included in the MD&A, you should become familiar with the SEC's guidance in this area well in advance of the initial drafting, as accumulation of information for all periods presented may take some time. In addition to the SEC's rules for MD&A, the SEC staff has issued interpretive guidance in this area and expects companies to follow these interpretations. Before companies begin drafting their MD&A sections, it would be beneficial to consider available guidance in Item 303 of Regulation S-K, SEC Release Nos. 33-6835, 33-8350, and 33-9144 and other SEC staff guidance.

Market risk. This section requires quantitative and qualitative information about the market risks to which the company is exposed, with a distinction being made between instruments entered into for trading or speculative purposes and those entered into for hedging and other purposes.

Categories of market risk include interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks. This disclosure may be provided in a variety of formats. Although the underwriters may request it, there is no requirement for a smaller reporting company to present market risk.

Description of business. This section is intended to provide the reader with material information essential to the evaluation of the company's products or services and industry. Disclosure should include, but is not limited to:

- The company's historical development
- Plans for the future
- Principal products produced or services provided
- Principal company markets and methods of distribution
- The status of any announced new products under development
- Sources and availability of raw materials or other necessary supplies
- Customer service and support
- Patents, trademarks, licenses, franchises, and concessions or other intellectual property held
- Extent to which the business is or may be seasonal
- Working-capital practices (e.g., if you are required to carry significant amounts of inventory to meet rapid delivery requirements or if you provide extended payment terms to customers)
- Dependence on one or a few customers
- Dollar amount of firm backlog, if applicable
- Government contracts
- Competitive conditions in the business
- Research and development expenditures during the last three years, including those funded by others
- Environmental matters
- Number of employees
- Export sales
- Facilities, both owned and leased
- Pending legal proceedings

Management and certain security holders; executive compensation. These sections provide background information about management personnel and major shareholders and their financial relationship with the company. Specifically, the company must provide:

- The names and ages of the directors, executive officers, and significant employees; their business experience; their remuneration (including stock options, prerequisites, and other indirect amounts); and any employment or severance agreements
- A description of the involvement in certain types of legal proceedings by a director and nominees for director or executive officer during the past 10 years

- For non-EGCs, a compensation discussion and analysis section that describes the material factors underlying compensation awarded to, earned by, or paid to executive officers in order to give the investor the information needed to understand the compensation policies and decisions made by management, including how the specific compensation elements are determined
- Tabular schedules of compensation for the named executive officers, the most notable being the summary compensation table, the grants of equity-based awards outstanding at the end of the year, and the options exercised and vested schedules
- Tabular schedule of director compensation



- A description of all stock option and other employee benefit plans that provide clear, concise, and understandable disclosure of all plan and nonplan compensation awarded to, earned by, or paid to the named executive officers and directors
- The stock holdings of officers, directors, and any shareholders who beneficially own more than 5 percent of any class of stock

If your management team or company founders have not previously been associated with public companies, the amount of sensitive information that must be disclosed in this area may not be known. You should consider preparing this information early in the registration statement drafting process to allow for adequate review by all parties.

Related-party transactions. This section includes information on transactions with persons or entities connected to the issuer, such as family members, directors, and officers or certain security holders. It should include the names of related parties, related parties' interest in the transaction, dollar amount of transaction, and the dollar amount of each related party's interest. If related-party transactions are significant within a company, they could come under intense scrutiny during the IPO process. Such transactions include loans by the company to officers or directors (which must be repaid prior to the IPO) and transactions with promoters, if the company has been in existence for less than five years.

Description of securities. This section gives the par or stated value of common and preferred stock, explanations of dividend rights and voting, liquidation, preemptive rights, and the transferability of each class of stock. It also describes any provision of the company's charter or bylaws that would have the effect of delaying, deferring, or preventing a change in control of the company, such as a classified board or

supermajority voting requirements. Any outstanding warrants or registration rights should also be disclosed. For companies with significant outstanding debt, a discussion of its debt securities and obligations should also be included.

Underwriting. This section should explain the plan of distribution for the offering. The various underwriters in the syndicate must be disclosed, as well as the number of securities to be purchased by each.

The underwriters' obligations, indemnification by the company, and any material relationships between any of the underwriters and the company should also be disclosed. In addition, any lock-up arrangement, whereby shareholders agree not to sell their shares for a period of time after the offering, is described here. See additional discussion on lock-ups at the end of this chapter.

Financial statements. The last section of the prospectus will normally be the financial statements. Form S-1 requires the following:

- Audited balance sheets as of the end of the last two fiscal years and audited statements of operations, cash flows, and changes in shareholders' equity and comprehensive income for the last three fiscal years, including footnotes to those statements.
- Unaudited interim financial statements (covering three-, six-, or nine-month periods subsequent to the company's latest fiscal year), if the registration statement will not be filed/declared effective within 45 days subsequent to the company's most recent fiscal year end. Note that interim balance sheets for the current year are compared to the prior fiscal year balance sheet, while the statements of operations are compared to the prior year corresponding period.

As discussed earlier, smaller reporting companies and EGCs are required to provide audited balance sheets, statements of operations, cash flows, and changes in shareholders' equity as of and for the two most recent fiscal years, including related footnotes. Note that, with the enactment of the FAST Act in 2015, the SEC now permits EGCs to omit from registration statements certain financial statements for periods that the issuer reasonably believes would not be required at the time of the contemplated offering.

Currently, the financial statements included in a registration statement on Form S-1 must be prepared in accordance with or reconciled to GAAP. FPIs are permitted to use International Financial Reporting Standards (IFRS) as an alternative to US GAAP. For circumstances in which an auditor of a nonissuer performs an audit in accordance with both generally accepted auditing standards (GAAS) and the standards of the PCAOB, AICPA AU-C 700.44 now requires auditors to use the form of report required by the standards of the PCAOB, amended to state that such audit was also conducted in accordance with GAAS.

Refer to Chapter 10 for financial statement requirements for foreign private issuers.

Audited financial statements of a business acquired or likely to be acquired may be required to be included in the registration statement. If your company has acquired a business within the last three years, or an acquisition is probable, calculations will need to be performed to determine if the acquisition is large enough to warrant the financial statements of the business to be included in the registration statement. The size of the acquisition will determine the number of periods for which financial statements are required. In addition to including audited financial statements of an acquired business in the registration

statement, the company may also be required to present unaudited pro forma financial information reflecting the business acquisition. Separate financial statements of equity method investees and financial guarantors may also be required if certain criteria are met. In 2019, the SEC proposed changes to these requirements. Consult with your auditor and attorneys to ensure that you are following the most recent disclosure requirements for acquisitions and dispositions.

Other. Other information in the registration statement includes tax consequences, shares eligible for future sale, identification of the law firms providing legal opinions, the identification of experts, and the availability of additional information.

Financial statements in a registration statement

In addition to the number of periods required, one of the most critical steps for a company undergoing an IPO is to determine the appropriate financial statements to include in its registration statement with the SEC. Common considerations in identifying the appropriate registrant financial statements include:

- *Recently organized registrant.* Sometimes the legal entity registering securities in an IPO is a newly formed company that will succeed to the operations of an existing business before the effective date of the initial registration statement. In such cases, a balance sheet of the recently organized registrant is often required in addition to the financial statements of the existing business.
- *Age of financial statements.* Financial statements of a registrant must meet the “age of financial statements” requirements when the registration statement is declared effective, although recent legislation and policy developments have

limited requirements for draft registration statements. In addition to the FAST Act discussed above, in August 2017, the staff of the SEC issued guidance to streamline the confidential submission process, effectively eliminating the circumstances under which an issuer will need to include interim period financial statements in its initial draft registration statement and subsequent confidential amendments. Issuers may omit from such confidential draft submissions financials (and related MD&A disclosure) that they reasonably believe will not be required to be presented separately at the time they launch (for EGCs) their IPO or publicly file (for non-EGCs) their registration statement. The age of financial statements generally refers to the specific annual and interim periods for which financial statements are required. Regulation S-X, Rule 3-12, provides guidance on such periods and on when the financial statements become stale (i.e., must be updated).

- *Predecessor financial statements.* A designation of “predecessor” is required when “a registrant succeeds to substantially all of the business (or a separately identifiable line of business) of another entity (or group of entities) and the registrant’s own operations before the succession appear insignificant relative to the operations assumed or acquired.” Because a predecessor’s historical financial information is considered important to an investing decision, when a predecessor is identified, the registration statement must also present the predecessor’s financial information and reflect such information as if it were the registrant’s. In other words, financial statements for both the registrant and its predecessor should be presented as of and for all periods that are required by Regulation S-X.

- *Carve-out financial statements.* Historical operations of a registrant may consist of a subsidiary or line of business that was previously part of a larger entity (parent). In many cases, the parent may not have historically accounted for the subsidiary or business line separately, and the registrant may have relied on the parent for certain functions. It is critical that carve-out financial statements identify the appropriate assets and operations of the registrant and capture all costs of doing business. Determining the composition of the carve-out financial statements can require significant judgment and depends greatly on the registrant’s specific facts and circumstances. In determining what to include in the carve-out financial statements, registrants may need to consider issues such as the parent’s existing reporting structure (e.g., segments and reporting units), the nature and size of the operations being carved out compared with the operations being retained by the parent, and the legal structure of the carve-out. Registrants should also consider the information in the “description of business” and MD&A sections of their registration statements and whether such information, along with the financial statements, provides a consistent, full, and transparent picture for investors.

Part II: Information not required in prospectus

Part II of Form S-1 requires disclosure of the expenses of issuance and distribution (excluding underwriters’ commissions), indemnification of directors and officers, and sales by the company of unregistered securities within the past three years. It also requires the filing of various exhibits, including the underwriting agreement, articles of incorporation and bylaws, stock option plans, pension plans, and certain contracts that are material to the company (e.g., employment agreements, leases and

mortgages, and key supply contracts). Companies may request confidential treatment of the material terms and provisions of certain contracts (e.g., pricing terms, royalty rates, milestone payments). If granted by the SEC, such terms and provisions are redacted and only the redacted version of the contract is available to the public. Obtaining confidential treatment from the SEC is not an automatic process and may involve substantial discussion with the SEC, which can delay the offering process. Concerns about public disclosure of market-sensitive terms of material contracts should be addressed with your counsel early in the IPO process.

Post-filing activities

SEC review. Once the registration statement is completed and the initial form has been publicly filed with or confidentially submitted to the SEC, it will be reviewed by the SEC's Division of Corporation Finance (DCF) to monitor compliance with the applicable disclosure and accounting requirements. You should anticipate that your IPO registration statements will receive a full cover-to-cover review by both a legal and accounting examiner. The DCF's staff commonly finds items that it questions or believes require additional explanation.

The SEC typically responds to the initial filing within 30 days by issuing a comment letter that requests clarification and/or seeks changes in the registration statement and prospectus.

The company, with the assistance of its advisers, prepares a written response to each comment. The accounting and legal responses are typically submitted to the SEC, along with an amendment to the registration statement that includes any changes made as a result of the SEC comments and other changes to update the registration statement. The SEC will review the amended registration

statement and response letter when filed and provide another comment letter. This process continues until all questions are resolved and may involve a number of rounds of comments and additional amendments. The timing of the SEC review on the amendments can vary based on the significance of the changes and the SEC's workload at the time but is often within 10 business days.

The comment letters from the SEC and the company's response letters ultimately will be available publicly on the SEC website following the offering. However, companies can request to have portions of their responses remain confidential. Some regular areas of focus for SEC comment letters with respect to financial disclosures are as follows:

- Non-GAAP financial metrics or operating data
- Executive compensation discussion and analysis
- Share-based compensation
- Significant business acquisitions and pro forma financial information
- Trends in the company's results of operations described in the MD&A
- Revenue recognition
- Complex equity instruments
- Clarification of accounting policies
- Clarification of related-party transactions

You will need to reach agreement with the SEC in response to all comments before the registration statement can become effective. From time to time, contentious issues with the SEC may be discussed via telephone. You should discuss these issues with your legal advisers and auditors prior to conversations with the SEC.

As the comment letter process nears completion, you will need to decide when to print the red herring. If the red herring is distributed before all substantive SEC comments are resolved, there is a risk that the SEC will require additional changes to the registration statement, and a redistribution of the red herring or a filing of a free writing prospectus may need to occur. Due to the risk of potentially having to distribute a revised red herring and the associated costs, most companies do not print their red herring until substantially all of the SEC's comments have been resolved. The cautionary language on the red herring is as follows:

The information in the preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities, and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

The red herring prospectus may be distributed to the general public. Since it is created before the pricing of the offering, it does not contain the exact offering price. However, the SEC requires that a bona fide estimated price range be disclosed. If the final pricing is outside the range set forth on the red herring that was distributed, you will have to determine any necessary legal requirements, which require a thorough and sometimes complex analysis and may require an additional filing and other actions. If this change occurs, you should consult with counsel and refer to the SEC guidelines on this topic.

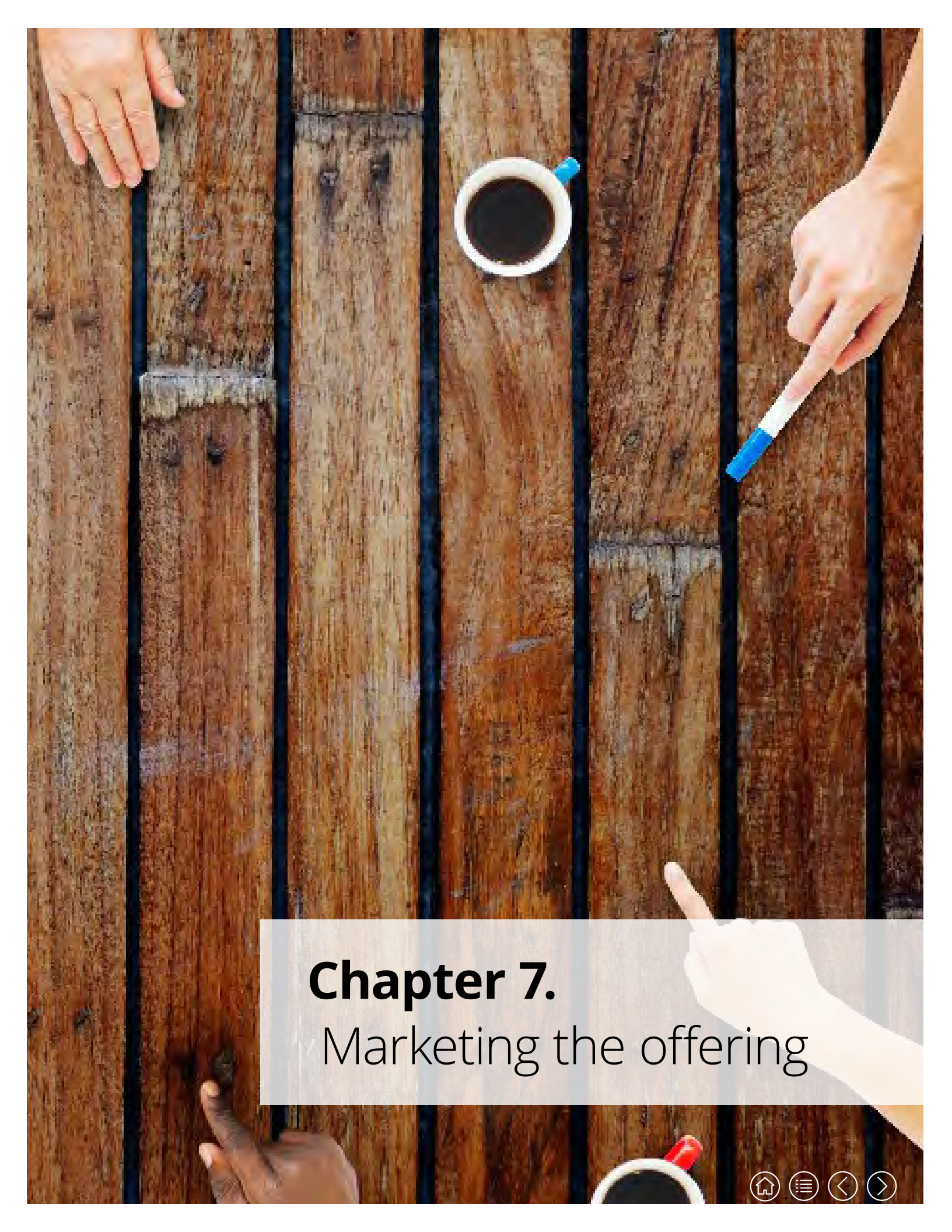
Filing and Printing. Early drafts of the registration statement are typically managed by the company's attorneys. After the initial drafts have been discussed and edited, the document is usually sent to a financial printer. Only a limited number of firms specialize in financial printing. These printers will be alert to, and aware of, changing SEC rules and regulations regarding prospectus and registration statement presentation and format. The printers will also be sensitive to your need for complete accuracy, timeliness, and confidentiality. The registration statement, including all exhibits, is required to be filed on the SEC's EDGAR system. Financial printers are set up to accommodate the EDGAR filing process. The SEC's EDGAR system can be accessed online at www.sec.gov.

Printing costs vary with the number of proofs and revisions made and the extent of the revisions required between the original filing and the final printing. Once the drafts are in printed form, involved parties invariably notice details that were overlooked. Authors' alterations are very expensive, as revisions are usually requested from the printer on a quick turnaround basis, often resulting in overtime charges.

However, revisions cannot be avoided, as they are essential and often reflect updates, clarifications, and other changes. With careful planning and organization, you can minimize revisions to save time, money, and frustration.

Keep everyone involved in reading the early drafts and do as much in-house editing as possible in advance of forwarding your draft to the printer. Art for the inside cover of the prospectus, illustrations and related legends, pie charts, and graphs should be prepared and approved in advance. The artwork must be just as accurate as the rest of your prospectus and must be submitted to the SEC for review. For example, in a company's registration statement, a color illustration of the company's various products was presented. The SEC questioned why one of the depicted products was not described in the prospectus and found that the product was no longer being manufactured. The result was the artwork had to be redone and reprinted.

The printing of the final prospectus will be done after the registration statement is declared effective by the SEC and pricing occurs.



Chapter 7.

Marketing the offering

Use the quiet period to make some noise for your IPO.

The time period between the initial filing of your registration statement and the time the registration statement is declared effective by the SEC is referred to as the waiting period or quiet period. This is a misnomer, however, as there is a flurry of extremely important activity during this time, occupying both the underwriters and the company. It is during this period that the marketing effort takes place.

The marketing process

After the registration statement is filed with the SEC, if the full underwriting syndicate has not already been identified, the company and its advisers, after considering input from the lead underwriter(s), will select additional underwriters who will participate in the offering. The syndicate is formed to obtain a broad distribution of the stock and to provide a balance between institutional and retail investors. It is also formed based on the strength of the research platform of the underwriters added to the syndicate.

In a firm commitment underwriting, the syndicate members participate with the lead underwriter(s) in assuming the risk of selling the stock. The lead underwriter(s) usually purchase the largest portion of the shares offered and bring into the group enough members to purchase the remainder. Each member makes a commitment to purchase a certain number of shares. When the SEC review process has reached a point that the company and the lead underwriter are sufficiently comfortable to print the red herring, the salespeople for the firms in the syndicate begin letting their clients know about the offering and furnishing them with copies of the preliminary prospectus. The syndicate may also include selling group members who are dealers that agree to purchase a specific number of shares

at the public offering price less a selling concession. These selling group members do not share all the potential liabilities under the securities laws with the underwriters and, as a result, receive less compensation.

Selling the shares is really a group effort. The lead underwriter(s) “build the book,” keeping track of the outstanding indications of interest. Some participating underwriters may actually sell two or three times their commitment, and others may sell none. The company’s participation in the roadshow is the single most important vehicle for building momentum for the offering. If momentum is strong, the lead underwriters’ “book” may reflect demand that significantly exceeds the size of the offering. The additional demand builds pricing tension and provides for continuing

demand in the secondary market. Because the underwriting agreement is not signed, the lead underwriter(s) and the syndicate members know how strong the demand is for the stock before they are legally committed to purchase shares from the company. So, as a practical matter, their risks in selling the shares are limited. After pricing occurs and the underwriting agreement is signed, the underwriters will be required to purchase the full amount of their commitment (except under very limited circumstances).

As indicated previously, the underwriters have a good sense of how many shares can be sold before they enter into the underwriting agreement. Although the preliminary prospectus indicates the anticipated number of shares to be sold and



the expected price range, the underwriters find out during the quiet period just how acceptable that price and offering size are to investors. Both factors may change before a registration statement becomes effective.

If your underwriters have done a thorough job, any changes during this period will generally reflect only changes in market conditions. However, it can still be difficult to anticipate demand and price sensitivity by investors until the deal is actually launched. Throughout the registration process, a series of pricing discussions are likely to occur between you and the lead underwriter(s) to set the initial price range and size of the offering and to apprise you of any needed revisions.

The 1933 Act generally prohibits any public offers of a security, either orally or in writing, before the initial filing of the registration statement. In this context, what constitutes an offer has been defined very broadly by the SEC and the courts. Any publicity effort, if deemed to create a favorable attitude toward the securities to be offered and to stimulate the market artificially, may lead to what is called “gun jumping” and result in possible sanctions or fines by the SEC in addition to delaying the offering.

There is an important exception to this general rule prohibiting gun jumping. An issuer or its authorized representative may “test the waters” before or after filing a registration statement by engaging in oral or written communications with qualified institutional buyers (QIBs) or institutions that are accredited investors to assess interest in a contemplated offering. Communications to “test the waters” will not have to be filed with the SEC as free writing prospectuses (discussed below).

The SEC, through various releases and rules, has established guidelines for the publication of information other than the prospectus, both before and after the filing

of the registration statement. It is very important that everyone in the company be aware of these guidelines. From the time that you begin to work on the IPO process, it is strongly recommended that all press releases and interview requests be cleared with your legal counsel and your lead underwriter(s). Your key executives should also meet with company counsel and the lead underwriter(s) to review what may and may not be said publicly about the company, as failure to comply can lead to a halt in the IPO process until the interest that has been stimulated (or perceived) has cooled down.

The practical period of time covered by the guidelines extends from 30 days prior to the filing of the registration statement to 25 days after the effective date of the registration statement, when broker-dealers are no longer required to deliver a prospectus to potential investors (or 90 days if, following the IPO, the company is not listed on a stock exchange or certain OTC markets). During this period, any publicity release can raise questions about whether the publicity is part of the selling effort, even if the release contains no offer or even a mention of the company’s effort to sell securities. Even before this period starts, there can be problems with communications that make any reference to the contemplated offering. In addition, if company executives give interviews where the ultimate date of publication is uncertain, problems can arise. In those cases, the company must take reasonable steps within its control to prevent further distribution of the information during the 30-day period prior to filing the registration statement. There have been many recent examples of companies having difficulty with the quiet period restrictions. Most notably, companies have granted interviews that were published during the quiet period. This can require the company to delay its offering until the increased publicity surrounding the offering has dissipated, and it may require additional filings with the SEC.

Rules promulgated by the SEC under the 1933 Act provide a “safe harbor” for continued communications at any time by or on behalf of a nonreporting issuer of regularly released factual business information by the same employees who have historically been responsible for providing such information to persons other than investors or potential investors and in the same manner and form as historically provided (Rule 169). This safe harbor does not permit the publication or dissemination of forward-looking information by nonreporting issuers. In addition, the safe harbor does not permit communications containing information about a registered offering or communications released as part of offering activities. The company should particularly not disclose anything as to valuation or projections of future performance. In addition, a specific rule (Rule 135) provides a safe harbor whereby certain limited announcements regarding a proposed public offering are deemed not to constitute an offering. In particular, Rule 135 provides that a notice of a proposed offering (e.g., a press release or a written communication directed toward employees) will not be deemed to be an offer if it states that the offering will be made only by a prospectus and the notice contains no more than the information specified by the rule, including the amount of securities you propose to sell, the proposed timing of the offering, and a brief explanation of the manner and purpose of the offering.

Companies should also pay particular attention to what information is on their company websites (including any hyperlinked information). Specifically, the company should avoid establishing a new website or expanding its existing website, other than in a manner consistent with past practice; avoid discussing the possibility of any issuance or offering of securities; have internal counsel or outside counsel review all information before it is posted on the company’s website; review its

website and remove any incorrect factual information as soon as possible; avoid posting “hype” regarding its anticipated financial performance; and avoid posting or hyperlinking to third-party websites or reports, if any exist. The SEC will typically review the company website and anything included therein that contains information inconsistent with information in the registration statement or information that could relate to the offering that may generate questions and result in potential legal issues.

Restrictions on offers

Once you have filed the registration statement and the quiet period begins, unless a “testing the waters” or other exception applies, you are forbidden from making any written offers, such as through sales literature regarding the offering, except by means of the red herring prospectus and a free writing prospectus (described below). Oral selling efforts (conversations between the company or its underwriters and the prospective buyers relating to information in the prospectus) are allowed, but you must be careful even in oral conversations. If oral communications are taped for broadcast or placed on a website, they can be considered a written offer in violation of SEC rules. In addition, oral offers must be consistent with the information contained in the registration statement to avoid any imbalance of information presented to some parties and not others. With the continued expansion in use of the internet and social media, the SEC has adopted rules to set the boundaries between oral and written communications. Written communication is defined to be any communication that is written, printed, a radio or television broadcast, or a graphic communication. Graphic communication includes all forms of electronic media, including audio and video recordings, facsimiles, digital storage devices, email, internet websites, computers, computer networks, or other forms of

computer data compilation. However, it does not include a communication that at the time of the communication originates live, in real time to a live audience, and does not originate in recorded form or otherwise as a graphic communication, although transmitted through graphic means. These definitions become very important in dealing with the roadshow (described below) and information distributed through social networking media. As a part of the briefing that counsel provides to officials in the company, these rules and their application, including to social networking sites, should be reviewed.

Free writing prospectus

To provide companies more flexibility during the offering, in light of modern communication methods and the wide dispersion of information, companies entering an IPO can use what are called “free writing prospectuses” during the quiet period after the registration statement that contains a price range that has been filed with the SEC. Free writing prospectuses are any written communication that constitutes an offer to sell or solicitation of an offer to buy securities that are or will be the subject of a registration statement, other than the statutory prospectus included in the registration statement, or a communication after the effective date of the registration statement that is accompanied or preceded by a statutory prospectus.

Free writing prospectuses must include a prescribed legend and most must be filed with the SEC. In addition, free writing prospectuses must be accompanied or preceded by a physical copy of the most recent statutory prospectus, although this requirement will be satisfied, in the case of an electronic free writing prospectus, if the latter contains an active hyperlink to the statutory prospectus. The free writing prospectus may contain additional information that is not found in the registration statement, but cannot

conflict with the information found in the registration statement. The rules pertaining to the free writing prospectus are complicated, and you should work with your legal counsel to ensure compliance.

Also allowed are short press releases under Rule 134. The Rule 134 “safe harbor” permits written communications that include information with respect to the securities being offered (the title, amount being offered, offering price, etc.); proposed stock exchange listing; the type of underwriting, names of underwriters, names of selling security holders, and a brief description of the intended use of proceeds of the offering, if then included in the disclosure in the prospectus that is part of the filed registration statement; the anticipated schedule for the offering and a description of marketing events (including dates); and a description of the procedures by which the underwriters will conduct the offering. The purpose of the press release is to announce the offering in the press and to tell interested parties where they can obtain a copy of the prospectus.

The roadshow

Common during the quiet period is a two- or three-week series of meetings between the company’s top executives and investors, often referred to as a roadshow. The roadshow often covers up to ten cities with key financial centers where institutional investors have indicated interest. In offerings where some shares will be sold internationally, the roadshow can include international stops.

The roadshow is usually organized by your lead underwriter(s). The filing requirements of roadshows are covered by an SEC rule (Rule 433 under the 1933 Act). Most roadshows will not be deemed to be free writing prospectuses and, therefore, will not need to be filed. Most are live presentations and will be deemed not to be written or graphic communications, even if they are

simultaneously webcast or transmitted with the live presentation into other locations. The slides that are generally used in presentations are also not deemed to be written or graphic communications if they are transmitted simultaneously with the live presentation. In contrast, prerecorded electronic roadshows for an IPO will be deemed free writing prospectuses and will have to be filed, unless the company makes at least one version of the electronic roadshow available without restriction to any person (for example, by posting it on the company’s website), which many companies do to avoid the filing requirement.

The roadshow’s purpose is to make presentations to key potential investors, portfolio managers, and analysts.

These meetings allow people to ask questions about the company and the material contained in the prospectus. The information covered during the presentations and the questions from participants will be similar to the earnings and analyst calls expected after you go public. They are meant to build enthusiasm and momentum for the offering.

You should view these meetings as opportunities to present the story of your company to those people who may buy your stock or influence the people who buy. The company needs to be extremely cautious prior to making forecasts to potential investors and should discuss the advisability of this with counsel well in advance of the roadshow.

Many of these key investors, portfolio managers, and analysts will be participating in future quarterly earnings announcement conference calls (after you go public) and will otherwise follow the company’s progress. If you are meeting them for the first time, you should take care to convince them that you and your associates are people of ability and integrity who will provide solid leadership for your company in the years ahead. Your

purpose is to demonstrate not only the growth potential of your company, but also the executive capacity of your team.

An investor relations advisory services firm may assist you with independent and objective counsel on prospective investors. The ranking of institutional investors based on investment criteria and quantitative modeling will assist in prioritizing opportunity and time during the investor outreach process. This will allow an issuer to be selective and precise when dealing with the institutional investment community.

Roadshows (like all other publicity during the offering), even if they do not have to be filed with the SEC, are still subject to the antifraud provisions of the securities laws. You should be very careful about what is said in the roadshow, and the company’s legal counsel should review the roadshow presentation. The underwriters, legal counsel, and investor relations advisory services firm may provide coaching on what questions to expect, how to answer them, and what you can and cannot say during those meetings. A roadshow can be very grueling, but it is an important component of the IPO process. Before, after, and between presentations, including at meals, you may meet with individual analysts who specialize in your industry and can help build relationships and coverage of your offering. The roadshow can educate the financial community about your company and help generate and sustain interest in your stock through the period of the offering.

The start of the roadshow is timed to coincide with the distribution of the red herring. Since the red herring used during the roadshow contains a price range, pricing discussions with the underwriters will have occurred prior to filing the amendment containing the red herring. Final pricing discussions occur after the completion of the roadshow. See further discussion of the roadshow in Chapter 7.

Companies (together with the lead underwriter) must file a request for acceleration of effectiveness of the registration statement. When the SEC grants your request for acceleration, it issues an order declaring your registration statement effective. The exchange (wherever the stock will trade upon completion of the offering) will also submit its approval of the company for listing. See further discussion of the closing in Chapter 8.

As soon as you receive notification of the effectiveness of the registration statement and pricing occurs, the transaction team will work to allocate shares and confirm orders that investors placed, as well as complete the final prospectus. This prospectus will have the final pricing information included and the red herring legend removed.

Blue Sky and FINRA clearance. Even though you file a registration statement with the SEC, you may need to comply with the “Blue Sky Laws” of the states where the stock is offered and sold. Blue Sky is the general term applied to the states’ securities laws and regulations.

The name is derived from a court decision on the constitutionality of Kansas securities regulations, which were aimed at preventing “speculative schemes which have no more basis than so many feet of blue sky.” Many states have adopted the Uniform Securities Act as the model for their state blue sky laws, which facilitates the state filing process; however, some states, like California, Illinois, New York, and Texas, have their own securities regulatory statutes and regulations, adding complications to the process. In order to facilitate an orderly national distribution of securities in offerings where the securities will be traded on national markets (and in certain other cases), Congress enacted the National Securities Markets Improvement Act (NSMIA) in 1996, which preempts from state registration public offerings of securities to be traded on national markets.

Where NSMIA does not apply, you will be subject to each individual state's securities laws and regulations. Many states do not permit you to circulate a preliminary prospectus until you have filed their state application forms for registration or notice. Thus, these filings, which are generally handled by underwriters' counsel, should be completed and filed with the applicable states when the registration statement is filed with the SEC. In contrast to the SEC, which focuses on disclosure only, some states do evaluate the "merits" of the offering and its suitability for investors in their state. The lead underwriter will generally advise you of the states in which the underwriters wish to sell the securities and the amount of securities to be qualified in each state.

SEC regulations also call for clearance by FINRA of the amount of the underwriters' compensation and other terms of the offering. FINRA reviews not only the underwriting discount, but also other compensation that the underwriters are deemed to receive in connection with the offering (such as options or warrants, finders' fees, and reimbursement of expenses normally borne by the underwriters) to determine whether the underwriting arrangements are fair and reasonable. It is mandatory to file the registration statement with FINRA within one business day of filing with the SEC if the offering is not exempt from filing with FINRA (IPOs are not exempt). This allows sufficient time for FINRA clearance and possible changes in the underwriting agreement that FINRA may require.

Lock-up agreements. At the time of filing the registration statement, the underwriters will want to make sure that highly visible employees and significant, existing shareholders of the company do not sell their shares for a period of time after the IPO is completed. This is generally done to allow an orderly trading market to develop

without additional shares being sold into the market. To make sure that this occurs, the underwriters will most likely require that the officers, directors, significant shareholders, and other listed management enter into a lock-up agreement whereby such shareholders agree not to sell or otherwise transfer their shares for a certain period of time. The duration of the lock-up agreement is typically 180 days for an IPO.

As you prepare for the registration process, you may want to consider your communication strategy with your employees and management team about these types of agreements.

Making the best presentation

When you and your top executives present your company and appear before analysts and investors, your company will likely be judged in large measure on the strength of your performance. How clear is the presentation? How well organized is everyone? Can you take the heat of tough questions?


While you can expect guidance and suggestions from your underwriters, attorneys, and others on how to conduct yourselves, you should be sure that you are comfortable with the presentation—both what is in it and how it is presented. This is your opportunity to tell your company's story, and you will have to execute operationally to meet the expectations that you and your management team have set through these presentations and the disclosure in the prospectus.

Choreography. Each member of the executive team should have a specific role in the presentation. It could be that the CEO provides a summary and an introduction to the company and his or her vision for its future. Other members of the team would provide more detail on marketing, sales, production, and finances. Typically, only two or three of the company's executives (including the CEO and CFO) present during the roadshow.

Visuals. Given today's sophisticated presentation packages and easy-to-produce graphics, audiences expect some visual backup in the form of slides or visual presentations to support statements about the company and its financial performance. While the presentation should not be based entirely on such visuals, they can be used judiciously to make the presentation clear and interesting. Anticipate potential problems and have backup alternatives immediately accessible.

Demonstration. A demonstration of your company's product or service can save a lot of explanation and will emphasize its importance much more compellingly than a verbal description. This is especially true if your product is technologically advanced. If the product is too big or the service is too complex for a demonstration, the use of videos or other visuals showing it being used by customers may be effective.

Preparation. Rehearse your presentation as much as possible. Each time, executives will discover a weakness or problem that should be corrected. Also practice answering potential questions; use team members (counsel and underwriters) to ask tough questions and then rehearse your answers. Videotaping the rehearsals will facilitate spotting the problem areas. The management team's formal presentation should not last longer than about 30 minutes. You should also allow for up to 30 minutes of questions following the presentation.



Chapter 8.

Closing the deal

You have come a long way—stay focused as the IPO rounds the corner.

The closing of a public offering is not a simple affair, as it is governed by both the underwriting industry's traditions and government regulation through the SEC. It is important that everything be done properly, so as not to risk wasting the long and costly preparation work and damaging the public perception of your company.

Signing the underwriting agreement

You do not enter into a written underwriting agreement generally until the end of the IPO process, after the registration statement is declared effective by the SEC and the offering price has been determined.

Until that time, you have only a draft copy of the underwriting agreement (which has been negotiated by your attorneys and the underwriters' counsel) and an oral understanding with the underwriters. The oral understanding with the underwriters is not a legal commitment by either side to proceed with any predetermined transaction.

Timing becomes quite important as the effective date of the registration statement approaches. The end of the roadshow and the completion of the bookbuilding process (resulting, it is hoped, in significant public momentum for the offering) are targeted to occur at about the same time as the SEC review process is completed. The registration statement is then declared effective by the SEC. On that day, the lead underwriter and the board (or the pricing committee of the company), which is responsible for reviewing the underwriter's report of indications of interest and allocation of shares, as well as agreeing on

final pricing, agree on the selling price to the public. The lead underwriter and the other underwriters participating in the syndicate also legally agree to their participation in the underwriting.

The agreement among underwriters authorizes the lead underwriter to sign the underwriting agreement, specifies the terms on which the other underwriters will participate in the syndicate, and spells out the responsibilities of the lead underwriter to manage the offering.

Immediately after the pricing of the offering, the underwriting agreement is signed by the company, the lead underwriter, and the selling shareholders, if any. The agreement includes the offering price of the stock; commissions, discounts, and expense allowances; the method of underwriting; representations and warranties; and an indemnification agreement. It also sets a number of conditions to the underwriters' obligation to complete the offering (for example, that there is no material adverse development impacting the company between pricing and closing, no material adverse development in financial markets, and no suspension in trading of securities generally on exchanges in the United States). Until the underwriting agreement is signed, the company has no legal right to compel the underwriters to proceed with the IPO. Once the underwriting agreement is signed, the company files a Rule 424 final prospectus with the SEC, actual sales commence, and the auditors give the underwriters an initial comfort letter as of the pricing date.

As a practical matter, once preparation of the registration statement reaches an advanced stage, underwriters rarely refuse to complete the offering, unless significant

adverse changes in market conditions occur or the registration process reveals serious problems at the company of which the underwriters were previously unaware. The lead underwriter has substantial motivation for completing the offering because it has invested considerable time and expense in investigating the company's business and affairs, helped to prepare the registration statement, and organized a selling syndicate. The public perception of a failed IPO is damaging to the reputations of both the company and the lead underwriter.

Should the market cool significantly during the waiting period, however, it is not unusual for an IPO to be postponed or canceled after the registration process starts. If the market is not willing to accept the originally anticipated price range or to absorb an offering as big as the one contemplated, the company may be faced with the choice of accepting an offering of unsatisfactory size or price, postponing the offering until the market improves, or even abandoning the IPO altogether and pursuing other financing options. In addition, if the final size or pricing of the offering is outside the range originally on the distributed red herring prospectus, it may be necessary to recirculate a new red herring prospectus with an updated price range.

Transfer agents and registrars

You will need to appoint a transfer agent and registrar before the closing of your IPO. Stock registration and transfer services are provided by commercial banks and trust companies. Companies often appoint the same organization to provide both services. Furthermore, the same firm can assist during the IPO process by acting as the custodian and/or paying agent in connection with the sale of securities by any selling shareholders.



For most companies undertaking an IPO, the question of transfer agents and registrars is one of both expediency and regulation. Both the NYSE and Nasdaq require that all listed securities be eligible to participate in the Direct Registration System (DRS) offered by the Depository Trust Company (DTC). In order for any securities to become DRS-eligible, DTC requires that the issuer appoint a transfer agent who is a participant in DTC's Fast Automated Securities Transfer program, as well as meet certain other

eligibility requirements. The DRS enables the registered shareholders to maintain and transfer their shares on the books and records of the transfer agent in book-entry form instead of a physical stock certificate. Participating in DRS can save costs involved with replacing stock certificates that are lost, stolen, or destroyed.

A public company will usually have a large number of shareholders and, as regular trading develops, shares likely

will change hands daily. Not only is this an administrative burden, but transfers must be handled with absolute accuracy, because any mistake can lead to claims against the company and possible financial liability. An independent transfer agent and registrar can assume responsibility for making sure that mistakes in stock transfers do not occur. Further, as a practical matter, your agreement with the underwriters may require such independent agents.

The transfer agent's primary responsibilities are to handle the transfer of shares from one person to another and to maintain the stock books that are the official records of the names and addresses of the company's shareholders. Ancillary responsibilities assigned to transfer agents may include disbursing cash dividends, mailing annual reports and proxies, distributing stock dividends, responding to shareholder inquiries relating to their shares, and keeping custody of unissued stock certificates.

Registrars are responsible for making sure that stock is not over-issued in excess of the number of authorized shares. They countersign all stock certificates to make sure the number of shares issued is not greater than the number surrendered for cancellation, and they keep active records of all the shares that are outstanding. Registrars also keep records of the certificates that have been canceled, lost, or destroyed, as well as those that have been issued, so that at any given moment they have an exact record of shares outstanding. Part of their role is to cross-check the work of the transfer agent.

See also Appendix D: A timetable for going public, for steps taken by a transfer agent and registrar in the illustrative IPO timeline.

The closing

Although the company shares will begin trading the morning after pricing, the closing marks the conclusion of the IPO. Unlike a firm commitment offering, in a best-efforts offering, the closing will occur after all the shares have been sold, or the company and underwriters agree that selling efforts can be concluded.

The closing is a formal meeting to exchange executed documents, including certificates and legal opinions. The closing is usually attended (in person or by phone) by the company and its counsel, the lead

underwriter and its counsel, the registrar and transfer agent, and the auditors. Among the actual exchanges that occur, the underwriters wire the company immediately available funds for the net proceeds of the offering, the registrar and transfer agent record the stock, the stock sold is credited to the underwriters' accounts through DTC, counsel provide their legal opinions, and the auditors give the underwriters a second comfort letter as of the closing date, referred to as the bring-down comfort letter.

Preparing for the closing day

There are a few requirements that every company would do well to prepare for in order to ensure a smooth closing. The first is a call between the underwriters, the company, and their respective counsel, which is referred to as a bring-down due diligence call. This call is an opportunity for the underwriters to ask the company a series of largely pre-distributed questions that are aimed at determining whether any material events have occurred since the most recent diligence call (typically, the call immediately prior to pricing) that might affect the IPO or the company. Such events may include new litigation involving the company, a material development in the company's business or expectations regarding its future financial results, or a previously unforeseen regulatory issue arising.

Assuming no new issues arise on the bring-down due diligence call, the morning of the closing day is characterized by legal formalities and the exchange of documents. Your counsel will check the SEC's website to confirm that no stop orders have been issued on your registration statement and also work with the underwriters' counsel to confirm that both sides have received final copies of all closing documents. Such closing documents typically include bring-down good-standing certificates; a certificate from officers of the company confirming the continued accuracy of the representations and warranties of the company in the

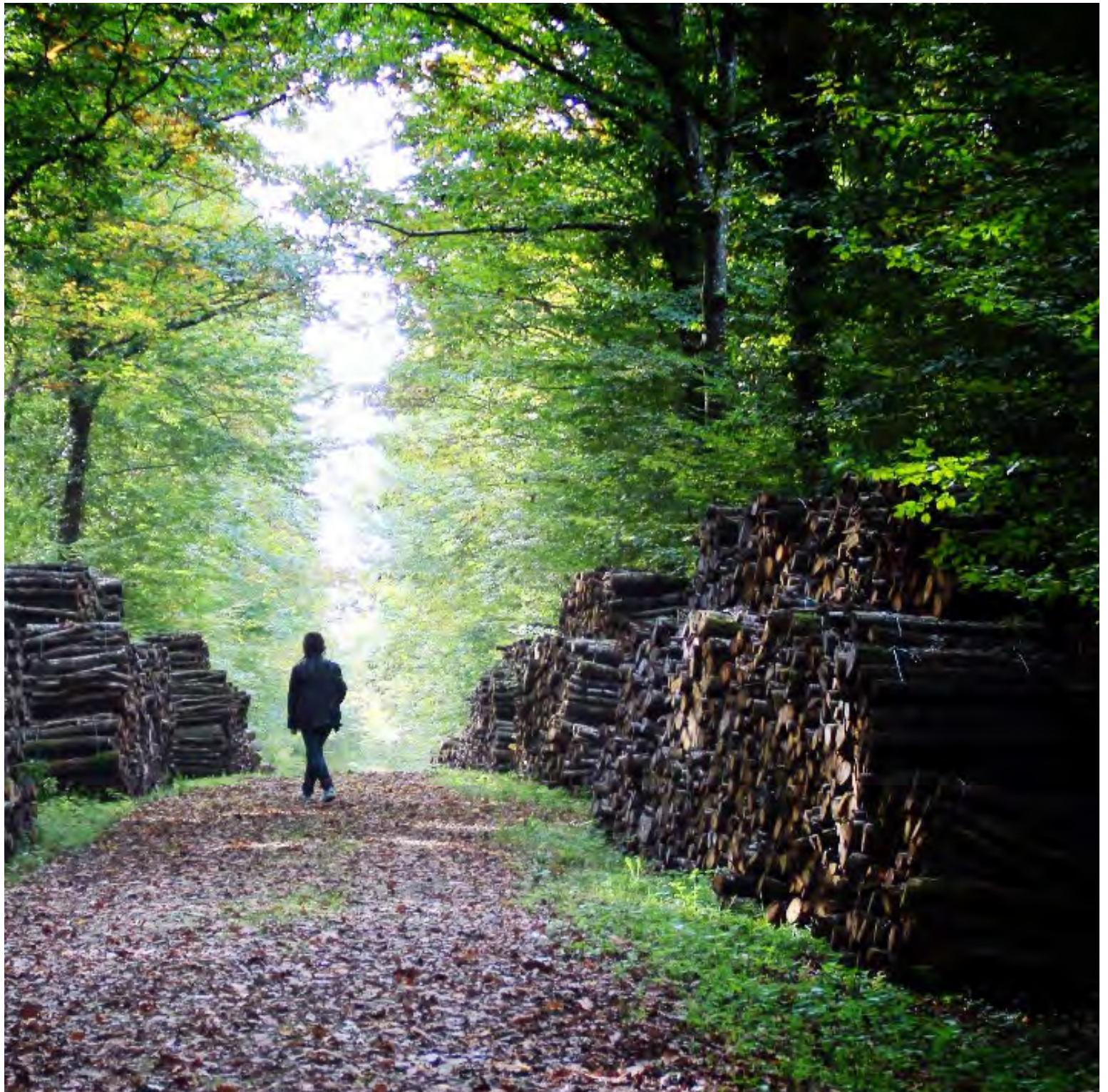
underwriting agreement; a certificate from the secretary of the company, which, among other things, certifies resolutions of the company; a bring-down of the auditors' comfort letter; and legal opinions and negative assurance letters. After all closing documents have been delivered, the underwriters will wire funds to the company. Once receipt of the wire is confirmed, the company, the underwriters, their respective counsel, and the transfer agent will participate in a brief closing call, after which the company typically issues a press release announcing the closing.

Countdown to losing EGC status

If you qualified as an EGC, closing marks the beginning of a countdown toward the date when you will lose EGC status. Under the JOBS Act, an issuer who qualifies as an EGC will continue to be viewed as such until, among other things, the end of the fifth year after the first sale of the issuer's common equity securities (for example, an IPO).

Other transactions could trigger the countdown to losing EGC status. For instance, an offering of securities to your employees as part of an employee stock plan that is registered on Form S-8 would likely qualify as a sale of common equity. This is an important consideration for EGCs that become public by way of a spin-off, rather than an IPO.

In practice, your counsel may schedule a pre-closing with the underwriters' counsel one day before the scheduled closing date to ensure that all necessary steps have been taken and all documents and signatures are ready to be delivered. Often, executed documents will be exchanged the day before closing "in escrow" to help ensure a smooth closing.



Chapter 9.

After you go public

The transition from a private to a public company marks the entrance to a dramatically new compliance and regulatory environment.

After going public, you will want to maintain the financial community's interest in your company. It is critical that you develop a strong relationship with the key members of the financial community (brokers, analysts, etc.), as they will play a significant role in sustaining the market's interest in your company.

Trading and aftermarket support

As part of its aftermarket support for your stock, your lead underwriter will typically be the principal market maker. Your underwriter should stand ready to purchase or sell your company's stock in the inter-dealer market. Upon the initial sale of your stock, some buyers may purchase shares with the intention of getting in for the initial price rise and then selling. These buyers will likely sell your stock the same day as the IPO or a few days after. This is typically referred to as "flipping." Some flipping is good in an IPO because it provides for additional supply in the aftermarket. But if too much occurs, flipping could adversely affect the aftermarket and force a stock's market price below its original IPO price. One of the key responsibilities of both the lead underwriter and the syndicate is to find the proper mix of short-term and long-term investors.

To stabilize the market and prevent or delay a decline in the stock's market price, the lead underwriter, acting on behalf of the syndicate, may enter bids to buy the stock from investors wishing to sell shortly after the IPO. This process is referred to as stabilization. Stabilization is a highly technical practice allowed by the SEC only when certain requirements are met.

Underwriters are also allowed to engage in "over-allotment," whereby more shares than initially purchased by the underwriter under the underwriting agreement are offered and sold. This practice automatically creates a "short" position, as the underwriters have then sold shares they do not own. The short position may be subsequently covered by the stock resold by speculative buyers. In addition, the underwriting agreement in a firm commitment offering often gives the underwriters an option to purchase more shares from the company for the purpose of covering over-allotments. This option is referred to as a "greenshoe" option, as it was first used in an offering by the Green Shoe Manufacturing Company. A typical over-allotment provision enables the purchase of an additional number of shares equal to up to 15 percent of the total shares offered in the IPO. The over-allotment option provides flexibility to the underwriters to fine-tune the distribution and to help create an orderly aftermarket.

Additionally, working with an investor relations advisory services firm can help you understand the subtle nuances of each potential investor's investment criteria. An analysis of trading in real-time fashion will give you the most current shareholder data available. By understanding how the former, current, and potential investors view the company and the management, you can deal with the investment community more efficiently and effectively, and cultivate long-term investment partners rather than short-term traders.

Your relationship with the financial community

Investment banking firms and retail brokerage houses maintain investment

research departments or groups of analysts that continually study the progress of public companies. In addition, several independent analysts also follow specific industries, as well as companies within those industries. The role of an analyst is to assist investors in evaluating and interpreting the financial performance of companies. You will likely run into analysts during your roadshow, so knowing who they are may prove to be helpful.

Appearances before societies of analysts can also be an integral part of your investor relations program. Analysts are in a position to recommend to investors the purchase or sale of your stock. Analysts that develop an interest in your company may conduct management interviews and visit your company to gather additional information. You should welcome opportunities to present to analysts, but always ensure the content of your presentation is limited to public information.

As a public company, in general, you will timely disclose material information (both positive and negative) to investors unless you have a legitimate business reason for keeping the information confidential. You should consult with legal counsel for guidance in this area, as the legal requirements are complex and very fact-specific. You may be required to file a Form 8-K Current Report with the SEC to disclose this information. See further discussion on Form 8-K requirements in the 1934 Act discussion below.

Public disclosures are generally made through SEC filings, press releases, and investor presentations. SEC Regulation FD (which stands for "Fair Disclosure") is



the guidance that must be followed with respect to such disclosures. To make sure that you have satisfied your obligations of full disclosure under SEC Regulation FD, you should select the method that best provides for broad and nonexclusionary distribution of information to the public in light of your particular distribution circumstances. You should never release material nonpublic information to individuals who may rely on the information to buy or sell stock. Nonpublic material information may include, among other things, new earnings guidance, confirmation of previously issued earnings guidance, and changes in trends in the issuer's business or industry, regulatory developments, and merger and acquisition activity. If the company or its representatives disclose material nonpublic data, SEC Regulation FD requires simultaneous or prompt public disclosure via Form 8-K.

To ensure appropriate, adequate, and timely disclosure, you should consult with legal counsel to adopt written disclosure policies and procedures that are consistent with Regulation FD. You may want to designate

an investor relations officer who will be responsible for (1) responding to requests for information from analysts, the financial press, and other interested parties; and (2) reviewing all proposed content to be disseminated publicly, including press releases, speeches, and interview material. Only certain employees should be authorized to speak with members of the financial community. Public companies generally have a disclosure committee. The committee's purpose is to review public disclosures prior to their issuance. The committee will normally be composed of members of senior management (including legal counsel) as well as employees from key areas of the organization.

Regulation FD applies to social media channels in the same way that it applies to company websites. Companies should be careful to advise their officers, directors, and employees that posting on social media could implicate Regulation FD.

Websites and social media channels may serve as appropriate channels to disseminate public information if investors have been made aware that they can locate the information on the respective channel. However, issuer communications through social media channels require a careful Regulation FD analysis. Public companies with a social media presence must manage these channels and have clear guidelines for corporate and personal accounts.

Your first annual shareholder meeting and proxy matters

Your first annual shareholder meeting is a major event for both your company and your shareholders. A successful annual meeting will support key corporate goals, whether that is obtaining approval for specific corporate actions, election of directors, or addressing issues relating to executive compensation. Planning the

annual shareholder meeting is a process that can be filled with complexities of all kinds—from complying with regulatory requirements to navigating industry challenges to flawlessly executing the mechanics. There are activities that require coordination among your transfer agent, the SEC, stock plan administrators, and other third parties. You should seek the advice of your transfer agent, as many offer services to assist you with the annual meeting.

Success at your first annual meeting requires an understanding of those investors who are eligible to vote. Depending on the amount of time and trading activity since your IPO, your voter base may have evolved. Comprehensive secondary market stock surveillance can help you separate institutional trading from retail trading, and gives you the ability to break out voting rights from investment rights and identify the current positions of large investors, their investment styles, and portfolio turnover rates.

Key sources of ownership information include (1) your transfer agent and equity plan administrator(s); (2) public filings, including SEC Form 13F and Schedules 13D and 13G; (3) voluntary disclosures via your investor relations dialogue; and (4) stock activity surveillance firms.

You also should become familiar with additional influencers, including institutional proxy advisory and corporate governance rating agencies. Also, many major institutional investors maintain dedicated internal corporate governance and proxy voting groups that may operate in coordination with the investment management side of their organization (i.e., the portfolio managers and analysts who are the primary focus of your investor relations dialogue). A proxy solicitation firm can help you to understand the relationships between these various parties and influencers—how they impact your unique ownership base (as it continues to

evolve over time)—and share with you best practices for investor engagement, proxy and corporate governance messaging, and proxy solicitation. These firms also have capabilities in “projecting” the vote on potential future voting issues, which many companies consider to be an important element of their due diligence prior to committing to particular courses of action.

As a company matures, there is typically a shift in the representative ownership profile. At the time of an IPO, the ownership profile is typically composed of a majority of founders and venture capitalists, shifting to a majority institutional investor ownership over time. Companies that retain majority founder/insider control following the initial IPO may be relatively immune from outside shareholder pressure in the early stages. That said, with board independence requirements and increased disclosure of your corporate activities, you will want to become familiar with shareholder influences and voting processes, and how they may impact your activities. You should consult with your legal advisers and proxy advisers about these matters.

Voting results from your annual shareholder meetings must be made public via an 8-K filing with the SEC (discussed later in this chapter) within four business days of the meeting.

These are readily accessible to investors, the media, and potential activists. Poor voting results may invite additional scrutiny of your company and potentially subject it to additional activism at future meetings. For these reasons, all voting matters must be attended to carefully.

Other aftermarket activities

As a newly public company, you will be required to make sure your stock records are in order. Keeping track of trades and issuances can be a tedious task. But it is a critical one, as ownership information on certain dates may affect corporate activities, such as

dividends, stock splits, or repurchases. Additionally, stock compensation plans for your employees may have complex formulas and require continuous monitoring to ensure compliance.

Compliance with securities laws

Once you are a public company, you are subject to a number of federal securities laws. You, your officers, and your directors should meet with your legal counsel to determine your obligations and responsibilities under these laws. This section briefly addresses some of the key obligations and responsibilities below. However, securities laws are extremely complex. Therefore, your legal counsel should be involved in ensuring that your company complies with the applicable laws.

The 1934 Act

As part of the IPO process, your stock is listed on a stock exchange, and a Form 8-A must be filed with the SEC to register the class of securities under the 1934 Act. Form 8-A is a short document that effectively incorporates portions of the 1933 Act registration statement. The 1934 Act subjects your company to certain legal and reporting requirements, some of which are described below.

Periodic reporting requirements

Form 10-K. A domestic registrant must file a Form 10-K report annually with the SEC. Form 10-K is designed to provide a continuing update of the disclosures in your registration statement. Consequently, it will contain information about the business, risk factors, management, the latest audited financial statements, management’s certifications regarding the accuracy of the financial statements and the effectiveness of the company’s ICFR, and MD&A of financial condition and results of operations. The due dates for the Form 10-K annual report vary depending on your accelerated filer status.

A smaller reporting company, as defined by Item 10(f) of Regulation S-K, is subject to fewer disclosure and information requirements. These scaled-down requirements include a less detailed description of the company’s business, no requirement to present selected financial data, a condensed management discussion and analysis, and no requirement for qualitative and quantitative disclosure regarding market risk. In addition, under the JOBS Act, EGCs are subject to reduced disclosure requirements for a limited period of time, including no selected financial data for any period prior to the earliest audited period presented in connection with an IPO. See table 9-1 for the 10-K filing deadlines. As of June 2018, a smaller reporting company may also qualify as an accelerated or large accelerated filer.

Form 10-Q. A domestic registrant must file quarterly reports on Form 10-Q (other than with respect to the fourth quarter of each year). These reports contain quarterly unaudited financial statements that must be reviewed (but not audited) by an auditor prior to the filing of the Form 10-Q and management’s certifications regarding the accuracy of the financial statements. These reports also contain management’s discussion and analysis of financial condition and the results of operations and narrative disclosures in the event that specific reportable events (e.g., legal proceedings, material changes in previously disclosed risk factors, changes in securities, and defaults on senior securities) have occurred during the quarter. The Form 10-Q is due at different dates depending on your accelerated filer status. See table 9-1 for the 10-Q filing deadlines.

Table 9-1. SEC filing deadlines

Filer	SEC Form 10-K	SEC Form 10-Q	SEC Form 8-K	IPO considerations
Large accelerated filer	60 days after end of fiscal year	40 days after end of fiscal quarter	Generally four business days after occurrence of event, with some exceptions	Not considered a large accelerated filer for the first 10-K filing after an IPO*
Accelerated filer (including emerging growth companies)	75 days after end of fiscal year	40 days after end of fiscal quarter	Generally four business days after occurrence of event, with some exceptions	Not considered an accelerated filer for the first 10-K filing after an IPO*
All other filers (nonaccelerated filers, certain smaller reporting companies, emerging growth companies)	90 days after end of fiscal year	45 days after end of fiscal quarter	Generally four business days after occurrence of event, with some exceptions	Filing deadlines remain the same for first 10-K filing after an IPO

* An issuer will not be considered a "large accelerated filer" or an "accelerated filer" until it has been subject to the reporting requirements of Section 13(a) or 15(d) of the 1934 Act for at least 12 calendar months and has filed at least one annual report pursuant to Section 13(a) or 15(d) of the 1934 Act.

Form 8-K. Form 8-K must be filed (or furnished, as applicable) within four business days of a reportable event, subject to certain exceptions (as indicated below). If the event occurs on a Saturday, Sunday, or holiday on which the SEC is not open for business, then the four-business-day period will begin to run on the first business day thereafter. Failure to file certain Form 8-Ks will result in the issuer losing its eligibility to use the short form registration statement on Form S-3 for a period of 12 months. The reportable events include:

- Entrance into, or termination of, a material definitive agreement
- Bankruptcy or receivership
- Mine safety reporting
- Completion of a significant acquisition or disposition of assets
- Results of operations and financial condition
- Creation of a direct financial obligation or an obligation under an off-balance-sheet arrangement
- Triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance-sheet arrangement

- Costs associated with exit or disposal activities
- Material impairments
- Notice of delisting or failure to satisfy a continued listing rule or standard or transfer of listing
- Unregistered sales of equity securities
- Material modifications to rights of security holders
- The submission of matters to a vote of security holders
- A change in the registrant's auditor
- The nonreliance on previously issued financial statements or a related audit report or completed interim review
- Changes in control of the registrant
- The departure of directors or principal officers
- Shareholder director nominations
- Director elections
- Principal officer appointments
- Compensatory arrangements of certain officers
- Amendments to articles of incorporation or bylaws
- A fiscal year change
- A temporary suspension of trading under the registrant's employee benefit plans
- Amendments to the registrant's code of ethics
- Waiver of a provision of the code of ethics
- Asset-backed securities triggering events
- Regulation FD disclosure
- Other material events

Of the Form 8-K reportable events listed above, disclosure of significant acquisitions or dispositions is one of the most cumbersome. Companies are required to initially report the consummation of a



significant business acquisition within four business days. Financial statements of the acquired business and pro forma financial information may be required to be filed depending on the level of significance of the acquisition. You may want to consult with your auditors or accounting advisers when acquisitions are possible to assess the need for financial statements of the acquired entity early in your due diligence process. Such financial statements and pro forma financial information may be filed by amendment to the Form 8-K up to 71 days after the initial Form 8-K reporting the acquisition was required to be filed.

In addition, some material changes may occur after the filing of a Form 10-K and require the financial statements in the previously filed Form 10-K to be

retrospectively adjusted for a material change. Such material changes may include those for the initial adoption of certain accounting pronouncements, or the classification of a component of your business as a discontinued operation. If you plan to file a new registration statement after you filed interim financial statements for the period of such a change, you generally must file updated financial statements and other financial information (e.g., MD&A, selected financial data) to reflect the retrospective adjustments for the periods before adoption of the change. If this situation occurs, you would typically file the updated financial statements and additional information on Form 8-K.

Filings to satisfy Regulation FD. For Form 8-K filings designed to satisfy Regulation FD, Form 8-K states, “[a] registrant either

furnishing a report on this form under Item 7.01 (Regulation FD Disclosure) or electing to file a report on this form under Item 8.01 (Other Events) solely to satisfy its obligations under Regulation FD . . . must furnish such report or make such filing, as applicable, in accordance with the requirements of Rule 100(a) of Regulation FD.” However, if the Form 8-K is used to disclose material, nonpublic information in accordance with Regulation FD, then the Form 8-K must be filed “simultaneously” for an intentional disclosure and “promptly” for a nonintentional disclosure. Promptly is defined to mean “as soon as reasonably practicable” but no later than 24 hours after the disclosure is learned of.

Section 404 of SOX. Section 404 of SOX requires that management and the auditor attest to the effectiveness of the ICFR of the company and issue a report in accordance with the PCAOB standards. Item 308 of Regulation S-K provides that a company’s annual report on Form 10-K must contain a report of management on the company’s internal control over financial reporting and an independent auditor’s attestation report on management’s assessment. An EGC may elect to be exempt from SOX 404(b)—the requirements for external audit attestation on internal controls over financial reporting.

Item 308(c) requires that a company disclose, on a quarterly basis in its quarterly report on Form 10-Q (or annual report on Form 10-K in the case of the fourth quarter of the company’s fiscal year), any change in internal control over financial reporting that occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, the company’s internal control over financial reporting.

Table 9-2. Section 404 filing requirements

Filer	404(a) reporting requirements	404(b) reporting requirements	
Large accelerated filer	Yes	Yes	Both the 404(a) and 404(b) reports are not required for the first annual filing after an IPO, but they are required for all annual filings thereafter, if applicable.
Accelerated filer	Yes	Yes	
Nonaccelerated filer	Yes	No	
Smaller reporting company	Yes	No	
Emerging growth company	Yes	No	

The section 404 reports are due at the same time as the related annual report (Form 10-K) in accordance with the schedule outlined in table 9-2.

XBRL requirements. All filers that use GAAP, including smaller reporting companies, and all foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the International Accounting Standards Board (IASB), are required to file an exhibit that contains their financial statements in an interactive data format, called eXtensible Business Reporting Language (XBRL). XBRL allows investors and others to pinpoint facts and figures by recognizing the information in the interactive data format through the use of searching software and analytical tools. New registrants will be required to submit an interactive data file for their first periodic report on Form 10-Q or Form 10-K or first annual report on Form 20-F or Form 40-F, if applicable. An XBRL exhibit is not required in an IPO filing.

Proxy statements and annual reports. Before you hold a shareholders' meeting or seek a written shareholder vote on a matter, you must send out an information statement or, if you are soliciting proxies, a proxy statement. If it is an annual meeting and directors will be elected, you must also send an annual report (often a glossy report updating the shareholders about the company and its activities and financial results for the past year). The SEC dictates the form of the proxy card and the content of the proxy statement (and any other proxy materials), which in some cases must be filed with the SEC 10 days before they are sent or given to shareholders. The SEC also has rules governing the annual report. The Dodd-Frank Act contains provisions that affect proxy statements for public companies. The current SEC rules require companies to include in proxy statements the nonbinding shareholder vote to approve compensation of executive officers and to conduct a say-on-pay vote.

An EGC is exempt from the requirement to hold nonbinding advisory shareholder votes on executive compensation arrangements for one to three years after it no longer qualifies as an EGC.

An EGC may comply with reduced executive compensation disclosure and is not required to calculate and disclose the ratio of the CEO's compensation to the median compensation of all employees.

Foreign Corrupt Practices Act (FCPA).

The FCPA applies to issuers of securities registered pursuant to the 1934 Act. The FCPA deals with certain foreign payments and imposes a statutory requirement for such companies to:

- Maintain reasonably accurate detailed records of their transactions.
- Maintain a system of internal accounting control that will be sufficient to reasonably assure that (1) transactions are executed in accordance with management's authorization, (2) the transactions are recorded properly, (3) access to assets is adequately safeguarded, and (4) there is adequate accountability for the assets.

The FCPA was enacted after widespread publicity about "sensitive payments" by companies to government officials, foreign companies and governments, suppliers, customers, and others. Even without the existence of the FCPA, companies (both private and public) would want to maintain adequate records and internal controls. With the FCPA, companies and their employees are subject to legal sanctions for noncompliance.

In addition, the FCPA contains strict prohibitions against bribery of foreign officials in order to obtain or retain business. Foreign officials can include certain individuals in state-owned commercial enterprises.

Beneficial ownership reporting. Any person or entity that beneficially owns, directly or indirectly, more than 5 percent of the outstanding shares of a class of stock must file with the SEC a statement containing certain information related to such person’s or entity’s ownership of such shares. This can be done, depending on the filer’s status and intentions, on a Schedule 13D or 13G.

Trading activities by insiders. Certain insiders, consisting of shareholders beneficially holding more than 10 percent of the stock and all directors and certain officers (defined in Rule 16a-1(f) of the 1934 Act), must file with the SEC reports regarding their stock holdings. An initial report must be filed by the time the company’s 1934 Act registration becomes effective. Any person who subsequently becomes subject to this requirement must file an initial report within 10 days of acquiring that status. Once the initial report is filed, any changes in beneficial holdings (such as through a purchase, sale, gift, exercise of options) must be reported before the end of the second business day following the change. The related filing requirements are complex, as are the definitions of beneficial ownership of shares under section 16 of the 1934 Act. As a result, informing all people subject to these rules is critical.

All such reporting persons (except as noted below) are also subject to the short-swing profit provisions of section 16 of the 1934 Act. If these individuals realize any profits from the purchase and sale or sale and purchase of the company’s stock within a six-month period, they may have to turn over such profits to the company. This can apply whether or not the trading was based on insider information.

Reporting persons are also not permitted to sell securities that they do not own at the time (sell “short”) or, if they do own them, that they do not deliver within 20 days after the sale (sell “short against the box”).

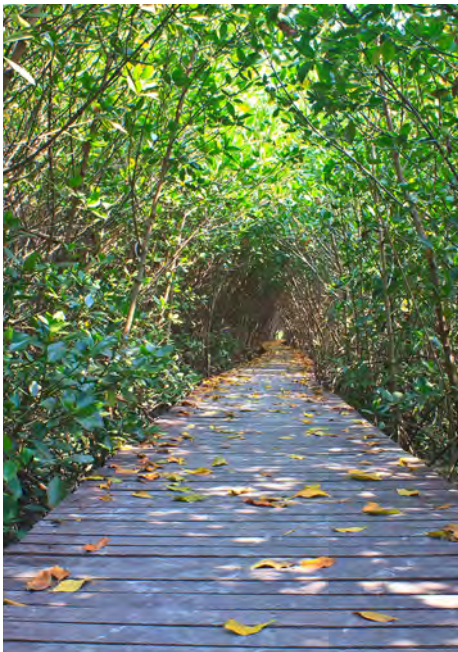
Some companies have “window periods” during which they encourage insiders who want to buy or sell stock to do so. Window periods are considered to be periods of time when all material information known by employees is public. They are typically defined as the period shortly after a public announcement of material events, such as earnings releases. There are advantages and disadvantages to using window periods; you should discuss them with your legal counsel before finalizing your policy.

Regulation BTR (Blackout Trading Restriction) of the SEC, adopted pursuant to section 306(a) of SOX, generally prohibits directors and executive officers from trading company stock acquired in connection with service or employment as a director or executive officer when participants in company stock and retirement plans are temporarily prohibited from trading. Regulation BTR was enacted to address the perceived abuses from the Enron case, where employees were prohibited from selling company stock in their company stock plans, but executives were not.

Trading on inside information

No person in possession of material nonpublic information about the company, including those who are merely aware of the information, should trade the company’s securities before the information is made public. This applies to officers, directors, and employees. It also applies to people outside the company who gain access to this information, including family members of officers, directors, and employees of the company. If an insider tips another person, both parties may be liable for damages under federal securities laws.

Private Securities Litigation Reform Act of 1995. The Private Securities Litigation Reform Act of 1995 (Reform Act) provides a safe harbor for companies to include forward-looking information within 1934 Act reports. Companies had historically held back from



disclosing these forward-looking statements due to legal actions asserting companies failed to meet these projections. The Reform Act provides a safe harbor for these statements. The Reform Act safe harbor does not apply in connection with certain transactions, such as IPOs.

Disposition of restricted securities and securities held by affiliates. Once an IPO is completed, the shares sold as a part of the IPO are freely tradable under the 1933 Act.

If there was outstanding stock previously issued in private placements, the stock is considered “restricted” for purposes of the 1933 Act and may be subject to resale restrictions.

Restricted stock, and any stock owned by persons who are considered affiliates of the issuer, generally cannot be resold in the public market unless the stock is included in a registration statement or is sold in compliance with Rule 144 under the 1933 Act.



Chapter 10.

Foreign private issuers

Foreign companies going public in the United States use essentially the same process, but there are some special rules that apply.

This chapter highlights some special rules for foreign companies considering whether to go public in the United States. There are many advantages to trading in the US capital markets for foreign companies, including higher stock valuations and improved visibility for consumer marketing and corporate recruiting.

Some foreign companies that conduct IPOs in the United States are called “foreign private issuers” under the federal securities laws. A foreign private issuer is defined as an issuer that is incorporated or organized under the laws of a foreign country, except if: (1) more than 50 percent of the issuer’s outstanding voting securities are directly or indirectly held by residents of the United States; and (2) any of the following: (a) the majority of the executive officers or directors are US citizens or residents, (b) more than 50 percent of the assets of the issuer are located in the United States, or (c) the business of the issuer is administered principally in the United States. This test is required to be performed annually as of the last business day of the issuer’s most recently completed second fiscal quarter, except in the case of the filing of an initial registration statement, in which case the determination may be made up to 30 days prior to the filing.

A foreign issuer (other than a foreign government) that does not meet (or no longer meets) the definition of an FPI must use the same registration and reporting forms as a domestic issuer.

A foreign private issuer may also voluntarily elect to use the registration and reporting forms that domestic issuers use. However, if the issuer elects to do so, it must comply with all the requirements of the domestic company forms.

The marketing process for the US IPO of a foreign private issuer is generally very similar to that described for a domestic issuer in Chapter 7. Both the team members and the pre-public planning process are the same, and there are also SEC filings. These processes, however, may be more time-consuming because of a lack of familiarity with US disclosure requirements and the integration of those requirements with requirements of the company’s home jurisdiction. This may be especially true for the accounting and due diligence portion of the work. In addition, the same SEC rules govern public communications before, during, and after the IPO. Some foreign private issuers that publicly offer securities in the United States do so using American Depositary Receipts (ADRs). ADRs are issued by a depositary institution in the United States (which has contracted with the foreign private issuer to provide this service) and represent a specified number of equity securities of the foreign private issuer. To go public in the United States, equity shares of a foreign private issuer are deposited with the depositary. The depositary then issues ADRs to investors purchasing securities in the IPO. ADRs are meant to mirror the underlying equity securities (though there can be important differences, which should be discussed with legal counsel). ADRs can be appealing to investors, as they can help mitigate some risks related to securities held in other countries. For instance, ADRs are priced in US dollars and dividends paid on the underlying securities are generally

distributed to ADR holders in US dollars. The SEC considers ADRs to be separate securities from the issuer’s underlying equity securities; therefore, a Form F-6 is required to be filed by the depositary bank with the SEC.

Set forth below are short summaries of some key differences in the IPO process for foreign private issuers. The summaries do not describe all the differences in disclosure and the application of the securities laws between foreign and domestic issuers. You should consult with your advisers before moving forward on the IPO process.

1933 Act filing and disclosure differences

Form F-1 (and not Form S-1) is used by foreign private issuers to register with the SEC. Form F-1 takes most of its disclosure requirements from those found in Form 20-F.

Form F-1 provides certain financial statement and disclosure accommodations different from those found in Form S-1. While the SEC provides these accommodations, often the underwriters will try to make most parts of the prospectus (other than the compensation disclosure) for a foreign private issuer look similar (substantively) to a prospectus for a domestic issuer.

Certain accommodations are available for a foreign private issuer in the IPO process.

While the JOBS Act (as complemented by the FAST Act) is arguably of less significance to foreign private issuers because of the accommodations otherwise available to them, foreign private issuers that qualify as EGCs are eligible for some additional accommodations. For example, only when filing as an EGC can a foreign private issuer omit certain historical financial information from the confidential submission prior to the distribution of the preliminary prospectus. Further, foreign private issuers that are EGCs can benefit from the reduced financial statement disclosure requirements and relaxed audit attestation requirements for EGCs.

Certain accommodations are available for a foreign private issuer in the Selected Financial Data section of the registration statement. For example, if the foreign private issuer is unable to provide information for the earliest two years of the five-year period without unreasonable effort or expense, those periods may be omitted. However, issuers are required to disclose the omission and the reason for the omission within the document. Also, the information may be requested by the underwriters. In Selected Financial Data, a foreign private issuer is required to disclose items generally corresponding to the following:

- Net sales or operating revenues
- Income (loss) from operations
- Income (loss) from continuing operations
- Net income (loss)
- Net income (loss) from operations per share

- Income (loss) from continuing operations per share
- Diluted net income per share
- Total assets
- Net assets
- Capital stock (excluding long-term debt and redeemable preferred stock)
- Number of shares as adjusted to reflect changes in capital
- Dividends declared per share

Selected Financial Data should be presented in the same currency as the financial statements.

A foreign private issuer must include a statement of capitalization and indebtedness in its Form F-1. While the form requires that this be dated no earlier than 60 days before the date of the prospectus, Section 6270 of the Division of Corporate Finance's Financial Reporting Manual allows companies to use data as of the same date as the most recent balance sheet.

The equivalent of the MD&A in a Form S-1 can be titled the "Operating and Financial Review and Prospects" in a Form F-1; however, substantively, it is very similar to the MD&A in domestic issuer offerings and is often titled the same.

Differences between a domestic issuer and a foreign private issuer in compensation disclosures are perhaps the area of most interest to executives. Foreign private issuers are permitted to provide only aggregate data (if that is what is provided in the issuer's home country) and much less information concerning individual executive compensation. This was done in part to accommodate similar disclosures to that of the home market.

Foreign private issuers must also disclose the effect of any laws, decrees, regulations, or other legislation of the home country

of the issuer that may affect the import or export of capital, including the availability of cash for use by the parent company or the remittance of dividends, interest, or other payments to nonresident security holders. Any tax consequences that can affect nonresident security holders must also be disclosed.

Audit requirements

A foreign private issuer is generally required to include audited balance sheets as of the end of the two most recent fiscal years (unless the audited balance sheet for a third fiscal year is required by an applicable jurisdiction outside the United States) and audited statements of operations, cash flows, and changes in shareholders' equity and comprehensive income for the three most recent fiscal years. Such financial statements may be presented in accordance with either US GAAP, IFRS (as issued by the IASB), or local accounting principles reconciled to US GAAP. Eligible foreign private issuers reporting under US GAAP that meet certain criteria may be eligible to present only two years of audited statements of operations, cash flows, and changes in shareholders' equity and comprehensive income, instead of three.

This accommodation also applies to issuers reporting under IFRS (as issued by the IASB) in their year of transition to IFRS, which are permitted to include only one year of comparative financial statements. Per International Accounting Standard (IAS) 1, however, the financial statements should include a third balance sheet as of the beginning of the comparative period. If the foreign private issuer presents its financial statements in accordance with local accounting principles, it must quantify and reconcile material differences to US GAAP and provide all other information required by US GAAP and Regulation S-X. However, first-time foreign private issuer registrants that present their financial statements in accordance with local accounting principles are only required to provide reconciliations

of the financial statements and selected financial data to US GAAP for only the two most recently completed fiscal years and any interim period required in the registration statement. While reconciliations to US GAAP initially are required for only two years, the registrant's financial statements still need to be presented in the registration statement for all of the periods noted above.

Foreign private issuers that file as EGCs are also eligible to take advantage of all accommodations in terms of audit requirements granted to EGCs.

Foreign private issuers may use any reporting currency they deem appropriate. The reporting currency must be prominently disclosed on the face of the financial statements.

Audited financial statements must be no older than 12 months at the date of filing of the IPO registration statement. This requirement is waived if the company is able to represent adequately to the SEC that it is not required to "comply with this requirement in any other jurisdiction outside the US and that complying with the requirement is impracticable or involves undue hardship." In that case, the financial statements should be no older than 15 months at the date of filing.

Unaudited interim financial statements covering at least the first six months of the fiscal year, as well as the comparable period in the prior year, will be required when the Form F-1 registration statement is dated more than nine months after the end of the last audited financial year. If the issuer has published interim financial information for a more current period, the most current interim financial statements must be included. In practice, however, the underwriters may require a foreign private issuer to include interim financial information consistent with the domestic requirements.

However, foreign private issuers are not required to include XBRL financial statements in their initial registration statement on Form F-1.

Corporate governance differences

The requirements governing the composition of the board and the audit committee can be different for foreign private issuers. Foreign private issuers are exempt from certain of the audit committee independence rules and can have certain members of the audit committee who are not independent, such as a nonmanagement employee representative, a nonmanagement affiliated person who only has observer status, or a nonmanagement governmental representative. In addition, the foreign private issuer is exempt from the audit committee independence rules if the foreign private issuer has a board of statutory auditors (or similar body) or has statutory auditors, established and selected pursuant to home country legal or listing provisions requiring or permitting such a board or body, and that board or body comports with additional SEC standards that are meant to assure that board or body or statutory auditors are independent of management. The SEC also has a provision under its independence rules recognizing that whereas in some foreign countries, companies have two-tiered boards, the "board of directors" means the supervisory or nonmanagement board.

Both the NYSE and Nasdaq also permit foreign private issuers generally to follow home country rules rather than their rules. However, both specify certain exceptions to these accommodations. The NYSE requires that all foreign private issuers (1) meet the SEC requirements for audit committees; (2) notify the exchange of noncompliance with exchange corporate governance rules; and (3) provide an annual written affirmation to the NYSE. Nasdaq specifies that foreign private issuers (1) must meet the SEC requirements for audit committees; (2) are

not exempt from the requirement to make a public announcement if its audit report contains a "going concern" qualification; and (3) must notify it in the event of any material noncompliance with Nasdaq corporate governance rules. In each case, the foreign private issuer must also disclose differences between home country and NYSE and Nasdaq corporate governance rules, as applicable.

After the IPO – 1934 Act filings

Periodic filings. A foreign private issuer is required to file a Form 20-F annual report with the SEC within four months after the fiscal year end. A Form 20-F is similar to a Form 10-K and extends certain accommodations to FPIs. However, similar to domestic issuers, annual reports on Form 20-F must contain the officer certifications required by SOX.

An FPI is exempt from the Form 10-Q quarterly reporting and Form 8-K current reporting requirements. Rather, an FPI is required to furnish promptly on Form 6-K material information that the issuer (1) files or is required to file with a stock exchange on which its securities are traded, if made public by that exchange; (2) makes or is required to make public by its domestic laws; or (3) distributes or is required to distribute to its securities holders. Also, the foreign private issuer must provide either a full English translation or an English summary of its documents that are written in a foreign language, in accordance with 1934 Act Rule 12b-12(d).

Corporate governance. Foreign private issuers with securities listed on a national securities exchange are required to provide a concise summary in their annual reports of any significant ways in which its corporate governance practices differ from those followed by domestic companies under the listing standards of that exchange.

Proxy rules. Section 14 of the 1934 Act requires public companies to comply with

certain rules regarding proxies. The 1934 Act makes it unlawful for companies to solicit proxies and to provide untrue statements with respect to tender offers, and also requires companies to provide equivalent information to holders, prior to any meetings, that would have been compulsory if a solicitation had been made. Rule 3a12-3(b) of the 1934 Act, however, exempts foreign private issuers from the proxy rules included within sections 14(a), 14(b), 14(c), and 14(f).

Under sections 14(d) and 14(e), foreign private issuers are prohibited from making tender offers that would allow the issuer to beneficially own more than 5 percent of the class of securities (subject to complying with certain conditions) or that include untrue statements of material fact.

Reporting of trading activities by insiders. FPIs and their officers and directors are exempt from the insider reporting and short-swing trading provisions of section 16 of the 1934 Act (as discussed in Chapter 9).

Regulation FD. As discussed in Chapter 9, Regulation FD requires companies to make public any material data or relevant information that may affect investment decisions that were disclosed to certain enumerated persons.

Regulation FD, however, specifically exempts foreign private issuers from its provisions. However, many foreign private issuers still comply with the regulation, in part because they can still be liable for selective disclosures under other theories of liability.

Foreign Corrupt Practices Act. Foreign private issuers are subject to both the books and records provisions and the anti-bribery provisions of the FCPA, just as are domestic companies. This can be a surprise to foreign companies and a number have been prosecuted under the FCPA.

SOX. Foreign private issuers that are reporting companies under the 1934 Act are subject to the provisions of SOX, though there are some limited accommodations made for foreign private issuers. These accommodations include the following: certain aspects of the audit committee independence rules (see above), periods in which trading is prohibited under company stock and retirement plans (Regulation BTR), and the use of non-GAAP financial measures (Regulation G). Issuers, both foreign and domestic, conducting an IPO are not required to immediately comply with the independent auditor attestation of the effectiveness of the ICFR under section 404 of SOX. See table 9-2 in Chapter 9 on this subject for the implementation schedule of such attestations. Because of the time and effort to implement SOX requirements, FPIs should pay particular attention to the requirements of SOX before they decide to proceed with an IPO in the United States. However, FPIs that qualify as EGCs should also consider the impact of the JOBS Act on the auditor attestation requirements.

Impact of Dodd-Frank Act on foreign private issuers

Certain provisions of the Dodd-Frank Act are applicable directly to foreign private issuers. The Dodd-Frank Act increases the SEC’s ability to pursue enforcement actions against foreign companies, including increased extraterritorial jurisdiction for enforcement action, increased liability imposed on secondary actors, increased resources for the SEC to administer these actions, and increased bounties for whistleblowers.

As certain sections of the Dodd-Frank Act are still within the SEC’s rule-making process, there is uncertainty as to their applicability to foreign private issuers.



Appendices

Appendix A:

The US Securities and Exchange Commission

In the chaotic securities markets of the 1920s, companies often sold stocks and bonds on the basis of promises of fantastic profits without disclosing any meaningful information to investors. These conditions contributed to the disastrous stock market crash of 1929. In response, the US Congress enacted the federal securities laws and, through the 1934 Act, created the Securities and Exchange Commission (SEC) to administer them.

The SEC is an independent regulatory agency with responsibility for administering the federal securities laws. The purpose of these laws is to protect investors by (1) promoting securities markets that operate fairly, and (2) ensuring that investors have access to all material information concerning publicly traded securities. The SEC also regulates firms engaged in investing, reinvesting, or trading of securities (including mutual funds); people who provide investment advice; and investment companies.

The SEC consists of five presidentially appointed commissioners, with one designated as chairman by the president of the United States and no more than three from one political party. The SEC’s functional responsibilities are organized into five divisions and 11 regional offices, each of which is headquartered in Washington, DC. The SEC’s staff is located in Washington, DC, and in 11 regional offices throughout the country. The divisions of the commission are:

Division of Corporation Finance
Corporation Finance has overall responsibility to oversee public disclosure of information important for investment decisions. Its work includes reviewing registration statements and periodic reports (e.g., Form 10-Ks, 10-Qs, 8-Ks, and 20-Fs) of domestic issuers and foreign private issuers, as well as documents concerning tender offers, proxy solicitations, and mergers and acquisitions. Corporation Finance also assists issuers with interpreting the SEC’s rules and regulations.

Division of Trading and Markets
Trading and Markets assists the SEC in maintaining standards for fair, orderly, and efficient markets. This includes the registration and regulation of broker-dealers and the oversight of the stock exchanges, the Municipal Securities Rulemaking Board, self-regulatory organizations, and other participants (such as transfer agents and credit rating agencies). Trading and Markets also oversees the Securities Investor Protection Corporation (SIPC), a private, nonprofit corporation that either acts as a trustee or works with an independent court-appointed trustee to recover funds in cases of missing assets. Essentially, the SIPC insures the securities and cash in the customer accounts of member brokerage firms.

Division of Investment Management
Investment Management ensures compliance with regulations regarding the registration, financial responsibility, sales practices, and advertising of investment companies and of investment advisers. In carrying out its responsibilities, Investment Management also reviews new product filings and other offering registration statements, proxy statements, and periodic reports.

Division of Risk Strategy and Financial Innovation
Created in September 2009, the Division of Risk Strategy and Financial Innovation assists the SEC in protecting investors by identifying new and developing risks and trends in the financial markets and making recommendations with respect to how these risks and trends affect the SEC’s regulatory activities. Risk Strategy and Financial Innovation was formed by combining the Office of Economic Analysis, the Office of Risk Assessment, and other functions.

Division of Enforcement
As its name indicates, the Division of Enforcement is responsible for ensuring issuers’ compliance with federal securities laws. Enforcement’s responsibilities include investigating possible violations and recommending appropriate action and remedies for consideration by the SEC.

Office of the Chief Accountant
As its name indicates, the Office of the Chief Accountant is responsible for establishing and enforcing accounting and auditing policy to enhance transparency of financial reporting.

For more information about the SEC, its responsibilities, and its organizational structure, visit www.sec.gov.

Appendix B:

Registration exemptions

The registration requirements of the 1933 Act apply to offerings of securities of both US and foreign companies or governments in the United States. An offering of securities may qualify for one or more exemptions or safe harbors from such registration requirements. The following exemptions and safe harbors under the federal securities laws are the ones most commonly relied upon. You must also comply with all applicable state securities law registration requirements or qualify for an exemption under state law.

It is also important to note that, whether or not securities are registered, the antifraud provisions under the federal and applicable state securities laws apply to all sales of securities. The following descriptions of the exemptions and safe harbors are summaries only, and an issuer should consult with its legal counsel prior to attempting any issuance of securities.

Private offering exemption

Section 4(a)(2) of the 1933 Act exempts from registration “transactions by an issuer not involving any public offering.” Whether a transaction involves a public or private offering is essentially a question of fact, and you should consider all surrounding circumstances, including factors such as the relationship between the offerees and the issuer, as well as the nature, scope, size, type, and manner of the offering. General solicitation and advertising in connection with this type of offering is prohibited. (See discussion of JOBS Act impact on general solicitation and advertising discussed under Rule 506 below.)

To qualify for this exemption, the purchasers of the securities must:

- Have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment (the “sophisticated investor”) or be able to bear the investment’s economic risk
- Have access to the type of information normally provided in a prospectus
- Agree to buy the securities for their own account without a view to resell or distribute to others immediately

The precise limits of this private offering exemption are uncertain and have generally been created pursuant to SEC interpretations and fact-specific court decisions. As the number of purchasers increases and their relationship to the company and its management becomes more remote, it is increasingly difficult to show that the transaction qualifies for the exemption. If securities are offered to even one person who does not meet the necessary conditions, the exemption may be unavailable.

Regulation D of the 1933 Act

Regulation D establishes three exemptions from 1933 Act registration, each with its own offeree qualifications and limitations.

Definitions of Regulation D terms

A sophisticated person is defined as someone with sufficient knowledge and experience in financial and business matters to make the person capable of evaluating the merits and risks of the prospective investment.

An accredited investor is currently defined as:

- A bank, insurance company, registered investment company, business development company, private business development company, or small business investment company

- An employee benefit plan (within the meaning of the Employee Retirement Income Security Act of 1974) if a bank, insurance company, or registered investment adviser makes the investment decisions or if the plan has total assets in excess of \$5 million or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors
- A charitable organization, corporation, or partnership with assets exceeding \$5 million
- A director, executive officer, or general partner of the company selling the securities
- A business in which all the equity owners are accredited investors
- A natural person with an individual net worth, or joint net worth with that person’s spouse, of at least \$1 million (excluding as an asset, the value of the primary residence, and as a liability, the debt secured by the primary residence up to the estimated fair market value of the residence)
- A natural person with individual income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year
- A trust with assets of at least \$5 million, not formed to acquire the securities offered, and whose purchases are directed by a sophisticated person

Rule 504

Exemption for limited offerings and sales of securities not exceeding \$1 million.

Rule 504 provides an exemption for the offer and sale by certain private companies of securities with an aggregate offering price not to exceed \$1 million in a 12-month period. Some of the most important characteristics of a Rule 504 offering are:

- You can sell securities to an unlimited number of persons.
- You may make a general solicitation or advertise to market the securities under certain circumstances.
- Purchasers receive securities that are “restricted” except under limited circumstances. This means that they generally may not resell their securities without registration or qualifying for an exemption from registration.

Rule 504 permits general solicitation or advertising in certain circumstances where state securities laws provide for investor protections or where only accredited investors (as defined above) purchase the securities. Rule 504 does not require issuers to give disclosure documents to investors.

Nonetheless, sufficient information should be provided to investors to avoid violating the antifraud provisions of the securities laws.

Rule 505

Exemption for limited offers and sales of securities not exceeding \$5 million.

Rule 505 provides an exemption for offers and sales of securities with an aggregate offering price not to exceed \$5 million in any 12-month period by an issuer that is not an investment company. Under this exemption, you may sell to an unlimited number of “accredited investors” (defined above) and up to 35 other persons (who do not need to satisfy the sophistication or wealth standards associated with other exemptions). The issued securities are “restricted.” General solicitation and advertising are not allowed. There are also

required disclosures to nonaccredited investors and certain other requirements.

Rule 506

Exemption for limited offers and sales without regard to dollar amount of offering, Rule 506 is a nonexclusive “safe harbor” under section 4(a)(2) and provides guidance on the availability of section 4(a)(2).

Issuers often try to comply with Rule 506 when conducting section 4(a)(2) private placements.

Under Rule 506:

- Any issuer may raise an unlimited amount of capital.
- You can sell securities to an unlimited number of accredited investors (defined above) and up to 35 other purchasers. Unlike Rule 505, all nonaccredited investors (either alone or with a purchaser representative) must be sophisticated (defined above).
- It is up to you to decide what information you give to accredited investors (defined above), so long as it does not violate the antifraud prohibitions. Nonaccredited investors must be given disclosure documents that generally are the same as those used in registered offerings.
- If all purchasers are accredited investors, and the issuer took reasonable steps to verify their status as accredited investors, there is no prohibition on general solicitation and advertising in connection with Rule 506 private offerings.
- You must be available to answer questions by prospective purchasers.
- Purchasers receive “restricted” securities. Consequently, purchasers may not freely trade the securities in the secondary market after the offering.

Rule 144A of the 1933 Act

Rule 144A provides a “safe harbor” from registration for sales by persons other than issuers who sell securities in compliance with four conditions:

- Securities may be sold only to types of entities that may be characterized as qualified institutional buyers or “QIBs,” as defined in Rule 144A(a)(1). Generally, a QIB is a large institutional investor deemed to have a certain level of financial sophistication.
- If the seller takes steps to ensure that securities are resold only to persons that it reasonably believes to be QIBs, securities may be offered to persons other than QIBs, including by means of general solicitation or general advertising.
- The seller must take reasonable steps to ensure that the purchaser is aware that the seller may rely on the Rule 144A safe harbor.
- The securities must not, at the time of issuance, be of the same class of securities listed on a national securities exchange or quoted on a US automated inter-dealer quotation system.
- When the securities sold are of an issuer that is neither a 1934 Act reporting company nor a company exempt from reporting pursuant to Rule 12g3-2(b) related to foreign filers, the holder of the securities and any prospective purchaser have the right to obtain certain specified, reasonably current information from the issuer.

Rule 144A does not apply to sales by the issuer of the securities (the company). However, because sales pursuant to Rule 144A are deemed not to be a distribution of securities, it allows issuers to make private placements of securities either directly or through investment banks acting as initial purchasers to QIBs, who can then resell such securities under Rule 144A. Such securities are “restricted securities” and many holders may not freely offer or sell them to the public. While a large market for Rule 144A securities exists among institutional investors, this market is less liquid than equity markets.

Regulation S of the 1933 Act

Regulation S clarifies that the registration requirements of section 5 of the 1933 Act do not apply to offers and sales outside the United States. Regulation S provides two nonexclusive safe harbors, which deem an offer or sale to have occurred outside the United States: (1) a safe harbor for issuers, distributors, their affiliates, and persons acting on their behalf (which distinguishes among three types of offerings and provides increasing levels of conditions for each such category to claim the safe harbor); and (2) a resale safe harbor for other persons. Offers and sales of securities by the issuer must be made in an “offshore transaction” and no “directed selling efforts” may be made in the United States.

Rule 701

Exemption for sales of securities through employee benefit plans.

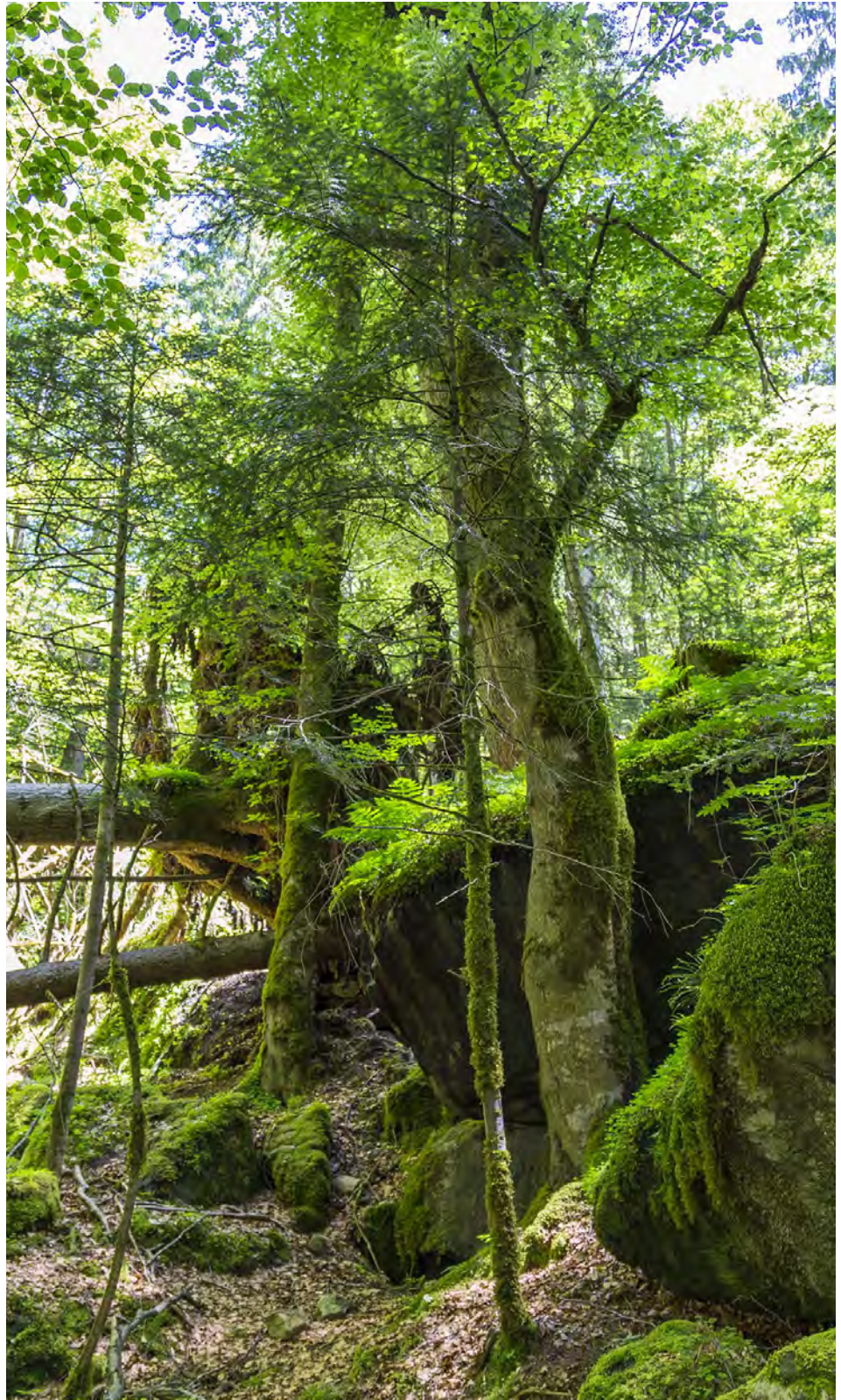
The SEC’s Rule 701 provides a safe harbor exemption from registration for offers and sales of securities if made to compensate employees. This exemption is available only to companies that are not subject to 1934 Act reporting requirements.

Under Rule 701:

You can sell at most, over a 12-month period, the greater of \$1 million, 15 percent of the total assets of the company, or 15 percent of the outstanding amount of the class of securities being offered and sold under Rule 701.

- If you sell more than \$10 million in securities in a 12-month period, you need to provide limited disclosure documents to your employees.
- Employees receive “restricted securities” in these transactions and may not freely offer or sell them to the public.

The offers and sales under this exemption are part of a single, discrete offering and are not subject to integration with any other offers or sales.



Appendix C:

The securities exchanges

Securities are bought and sold in a number of different markets. The best known are the NYSE and Nasdaq. In addition, six regional exchanges are located in cities throughout the country. Corporate securities may be traded on an exchange only after the issuing company has applied and met the exchange's listing standards. Such standards may include requirements as to the company's assets, number of shares publicly held, and the number of shareholders. All the markets apply different standards to initial listings than they do for continued listings. Listing standards are updated frequently, and you can obtain the current parameters for inclusion and more details at the following websites: www.nyse.com and www.nasdaq.com.

Nasdaq Capital Market initial listing requirements

Companies must meet all of the criteria under at least one of the three standards below.

Requirements	Standard 1	Standard 2	Standard 3
Stockholders' equity	\$5 million	\$4 million	\$4 million
Market value of publicly held shares	\$15 million	\$15 million	\$5 million
Operating history	2 years	N/A	N/A
Market value of listed securities ¹	N/A	\$50 million	N/A
Net income from continuing operations (in the latest fiscal year or in two of the last three fiscal years)	N/A	N/A	\$750,000
Publicly held shares ²	1 million	1 million	1 million
Bid price/Closing price	\$4/\$3	\$4/\$3	\$4/\$3
Shareholders (round lot holders) ³	300	300	300
Market makers ⁴	3	3	3
Corporate governance ⁵	Yes	Yes	Yes

¹ The term "listed securities" is defined as "securities listed on Nasdaq or another National Securities Exchange."

² "Publicly held shares" is defined as the total shares outstanding less any shares held directly or indirectly by officers, directors, or any other person who is the beneficial owner of more than 10 percent of the total shares outstanding of the company. In the case of ADRs, at least 400,000 shall be issued.

³ Round lot holders are considered holders of 100 shares or more. The number of beneficial holders is considered in addition to holders of record.

⁴ An electronic communications network (ECN) is not considered a market maker for the purpose of these rules.

⁵ In addition to the above quantitative requirements, companies must comply with all corporate governance requirements as set forth in the Rule 5600 Series.

Nasdaq Global Select Market initial listing requirements

Companies must meet all of the criteria under at least one of the four standards below.

Requirements	Standard 1	Standard 2	Standard 3	Standard 4
Pretax earnings ¹ (income from continuing operations before income taxes)	Aggregate in prior three fiscal years \geq \$11 million, and each of the two most recent fiscal years \geq \$2.2 million, and each of the prior three fiscal years $>$ \$0			
Cash flows ²	N/A	Aggregate in prior three fiscal years \geq \$27.5 million and each of the prior three fiscal years \geq \$0	N/A	N/A
Market makers ³	3 or 4	3 or 4	3 or 4	3 or 4
Revenue	N/A	Previous fiscal year \geq \$110 million	Previous fiscal year \geq \$90 million	N/A
Market capitalization ⁴	N/A	Average \geq \$550 million over prior 12 months	Average \geq \$850 million over prior 12 months	\$160 million
Bid price ⁵	\$4	\$4	\$4	\$4
Round lot shareholders	450	450	450	450
or	or	or	or	or
Total shareholders	2,200	2,200	2,200	2,200
Total assets	N/A	N/A	N/A	\$80 million
Stockholders' equity	N/A	N/A	N/A	\$55 million
Publicly held shares ⁶	1,250,000	1,250,000	1,250,000	1,250,000
Market value of publicly held shares	\$45 million	\$45 million	\$45 million	\$45 million
Corporate governance ⁷	Yes	Yes	Yes	Yes

¹ In calculating income from continuing operations, Nasdaq will rely on a company's annual financial information as filed with the SEC in the company's most recent periodic report and/or registration statement. If a company does not have three years of publicly reported financial data, it may qualify under Rule 5315(f)(3)(A) if it has (i) reported aggregate income from continuing operations before income taxes of at least \$11 million; and (ii) positive income from continuing operations before income taxes in each of the reported fiscal years. A period of less than three months shall not be considered a fiscal year even if reported as a stub period in the company's publicly reported financial statements.

² In calculating cash flows, Nasdaq will rely on the net cash provided by operating activities reported in the statements of cash flows, as filed with the SEC in the company's most recent periodic report and/or registration statement, excluding changes in working capital or in operating assets and liabilities. A period of less than three months shall not be considered a fiscal year even if reported as a stub period in the company's publicly reported financial statements.

³ A company that also satisfies the requirements of an electronic communications network (ECN) is not considered a market maker for the purpose of these rules. A company that meets the requirements of the Nasdaq Global Market (NGM) Income Standard (Rule 5405(b)(1)) or the NGM Equity Standard (Rule 5405(b)(2)) is required to have at least three registered and active market makers. Otherwise, the company is required to have at least four registered and active market makers.

⁴ In the case of a company listing in connection with its initial public offering, compliance with the market capitalization requirements of Rules 5315(f)(3)(B) and 5315(f)(3)(C) will be based on the company's market capitalization at the time of listing.

⁵ The bid price requirement is not applicable to a company listed on the Nasdaq Global Market that transfers its listing to the Nasdaq Global Select Market.

⁶ Publicly held shares is defined as total shares outstanding, less any shares held directly or indirectly by officers, directors, or any person who is the beneficial owner of more than 10 percent of the total shares outstanding of the company.

⁷ See "Corporate governance" in Chapter 4.

Nasdaq Global Market initial listing requirements

Companies must meet all of the criteria under at least one of the four standards below.

Requirements	Standard 1	Standard 2	Standard 3	Standard 4
Stockholders' equity	\$15 million	\$30 million	N/A	N/A
Market value of listed securities ¹	N/A	N/A	\$75 million	N/A
Total assets and Total revenue (in latest fiscal year or two of last three fiscal years)	N/A	N/A	N/A	\$75 million and \$75 million
Income from continuing operations before income taxes (in latest fiscal year or two of last three fiscal years)	\$1 million	N/A	N/A	N/A
Publicly held shares ²	1.1 million	1.1 million	1.1 million	1.1 million
Operating history	N/A	2 years	N/A	N/A
Market value of publicly held shares ³	\$8 million	\$18 million	\$20 million	\$20 million
Bid price	\$4	\$4	\$4 ⁴	\$4
Shareholders (round lot holders) ⁵	400	400	400	400
Market makers ⁶	3	3	4	4
Corporate governance ⁷	Yes	Yes	Yes	Yes

¹ The term "listed securities" is defined as "securities listed on Nasdaq or another National Securities Exchange."

² "Publicly held shares" is defined as the total shares outstanding, less any shares held directly or indirectly by any officers, directors, or any other person who is the beneficial owner of more than 10 percent of the total shares outstanding of the company.

³ Companies must meet the bid price, publicly held shares, and round lot holders' requirements as set forth in Rule 5405(a) and at least one of the Standards in Rule 5405(b).

⁴ Seasoned companies (those companies already listed or quoted on another marketplace) qualifying only under the Market Value Standard must meet the market value of listed securities and the bid price requirements for 90 consecutive trading days prior to applying for listing.

⁵ Round lot holders are shareholders of 100 shares or more. The number of beneficial holders is considered in addition to holders of record.

⁶ An electronic communications network (ECN) is not considered a market maker for the purpose of these rules.

⁷ In addition to the above quantitative requirements, companies must comply with all corporate governance requirements as set forth in the Rule 5600 Series.

NYSE Initial listing requirements

US companies must meet the minimum distribution criteria and one of the four financial criteria—earnings, cash flow, pure valuation, or assets and equity—under the US standards.

For non-US companies, the NYSE offers two sets of standards—domestic and worldwide—under which companies may qualify for listing. A company must satisfy both the distribution criteria and financial criteria (earnings and either cash flow or pure valuation) within that particular standard.

Distribution and size criteria	US standards	Non-US standards	
		Domestic	Worldwide
Round lot holders or	400	400 (US)	5000
Total shareholders ... together with	N/A	2,200	N/A
Average monthly trading volume (for the most recent six months) or	N/A	100,000 shares	N/A
Total shareholders ... together with	N/A	500	N/A
Average monthly trading volume (for the most recent 12 months)	N/A	1,000,000 shares	N/A
Public shares outstanding ¹	1,100,000	1,100,000	2,500,000
Market value of public shares: IPOs, spin-offs, carve-outs, and affiliated companies ¹	\$40 million	\$40 million	\$100 million
Market value of public shares: All other listings	\$100 million	\$100 million	N/A
Stock price criteria			
Stock price	\$4	\$4	\$4
Financial criteria⁴ – Must meet one of the following standards:			
Earnings			
Aggregate pretax earnings for the last three years, and	\$10 million	\$10 million	\$100 million
Minimum in each of the two recent preceding years pretax or	\$2 million ²	\$2 million ³	\$25 million
Aggregate pretax income for the last three years, and	\$12 million	\$12 million	N/A
Minimum in the most recent year, and	\$5 million	\$5 million	N/A
Minimum in the next most recent year	\$2 million	\$2 million	N/A
Valuation with cash flow			
Global market capitalization ¹	\$500 million	\$500 million	\$500 million
Revenues in the most recent 12-month period	\$100 million	\$100 million	\$100 million
Aggregate cash flow for the last three years	\$25 million ³	\$25 million ³	\$100 million
Minimum cash flow in each of two preceding years	N/A	N/A	\$25 million

Pure valuation with revenues			
Global market capitalization ¹ and	\$750 million	\$750 million	\$750 million
Revenues for the most recent fiscal year	\$75 million	\$75 million	\$75 million
Asset and equity			
Global market capitalization ¹	\$150 million	N/A	N/A
Total assets	\$75 million	N/A	N/A
Shareholders' equity	\$50 million	N/A	N/A
REIT		US standards	
Stockholders' equity		\$60 million	
Funds and BDCs		US standards	
Net assets		\$60 million	

¹ In connection with IPOs, the NYSE will accept assurance from the company's underwriter that the offering will meet or exceed the exchange standards.

² Third year must be positive.

³ All three years must be positive.

⁴ For new entities with a parent or affiliated company listed on the NYSE, the global market capitalization requirement is \$500 million if the affiliated company has at least 12 months of operating history, the affiliated listing company is in good standing, and the affiliated listed company retains control of the entity.

Appendix D:

A timetable for going public

A projected timetable for an IPO is offered below. In this example:

- The company's fiscal year end is December 31.
- Audited financial statements are available for each year that the company has been in existence, and the auditors are in the process of completing the current year's audit.
- It should be noted that this is only an example of an IPO timetable. There are many variables that can either cause the timing to be accelerated or delayed. As an example, the expected period for the SEC to respond with its initial comments on the company's first registration statement is approximately 30 days. While this is the time period that the SEC aspires to, the time period to receive comments may be longer.
- The timeline begins with an organizational meeting and due diligence. There may be additional activities, which could occur prior to this organizational meeting (as discussed throughout this document), that are not reflected in the example.

The many documents and procedures listed in the timetable are explained in Chapters 6 through 8. Abbreviations are as follows: ABC = company, CC = company counsel, A = auditors, T = transfer agent/registrar, U = underwriters, and UC = underwriters' counsel.

ABC Company: Schedule of events and responsibilities

Summary of key dates	Dates	Days
Organizational meeting and due diligence	December 15	1
First draft of Form S-1 distributed without financial statements	December 27	13
Due diligence/first drafting session	January 6	23
Second drafting session	January 14	31
Third drafting session	January 21–22	45
Final drafting session at printers	February 4–5	52–53
Target confidential submission date with audited financial statements where other parts of prospectus are prepared well in advance	February 5	53
Expected receipt of first round of SEC comments	March 7–8	83–84
Drafting session	March 9–10	85–86
Roadshow	April 1–16	108–119
Public offering effective	April 16	124
Closing	April 20	127

Detailed schedule

Date	Activity	Responsibilities
Prior to December 1	Board meeting(s) to discuss IPO and ultimately to authorize preparation of registration statement and engagement of legal counsel and the lead underwriter	ABC, CC
December 15	Initial organization meeting and due diligence: Review timetable Discuss underwriters' fees, compensation, and other underwriter issues Discuss proposed lock-up arrangements Identify accounting, legal, tax, and other issues Provide customer contacts Select printer Review financial forecasts Management due diligence presentations Discuss transfer agent and registrar Prepare list of parties involved (phone numbers, addresses, secretaries, etc.) referred to as the working group list	All
December 27	First draft of registration statement distributed	ABC, CC
January 6	First drafting session and due diligence: Complete business/due diligence presentations Review draft of registration statement Discuss obstacles	All
January 6–10	Revise registration statement; underwriters' counsel to draft and distribute underwriting agreement	All
January 11	Distribution of second draft of registration statement	ABC, CC
January 14–15	Second drafting session to review registration statement	All
January 15–31	Questionnaires and lock-ups completed by officers, directors, and 10 percent shareholders, and returned to company and underwriters' counsel for review	ABC, CC
January 18	Distribution of third draft of registration statement	ABC, CC
January 18	Distribution of draft of management's discussion and analysis of financial position and results of operations	ABC, CC, A
January 21–22	Third drafting session to review registration statement	All
January 23	Company counsel and underwriters' counsel discuss underwriting documents	CC, UC
January 28	Board meeting to review registration statement and take other actions related to the offering, including to authorize filing of the registration statement, appointment of transfer agent and registrar, and listing on an exchange and any other matters Authorize any Blue Sky filing, if applicable Discuss items to include in auditor comfort letter and auditing procedures Appoint pricing committee, authorize other actions necessary to complete offering, and authorize corporate housekeeping matters	ABC, CC, U

Detailed schedule

Date	Activity	Responsibilities
February 3	Year ended December 31 audited financial statements available and provided to printer	ABC, A
February 4–5	All hands meetings: Discuss any discrepancies between text of registration statement and financial statements Review and confidentially submit draft registration statement	All
QUIET PERIOD BEGINS		
February 5	File underwriting agreement with FINRA	UC
	File listing application with exchange; make any required Blue Sky filing	ABC, CC
February 6	Begin roadshow presentation preparation and rehearsal	ABC, U
March 7–8	SEC comments received; responses prepared	All
March 9–10	Make changes in registration statement or otherwise address SEC comments; miscellaneous discussions with SEC staff regarding comments	All
	All hands meeting to review first amendment to registration statements, discuss other issues, review underwriting agreement, etc.	
March 12	Confidentially submit draft amended registration statement with responses to first round of SEC comments	ABC, CC, UC
	Continue roadshow preparation and rehearsal	ABC, U
March 22	SEC comments on amendment received; responses prepared	All
March 23	Confidentially submit amended draft registration statement with responses to second round of SEC comments	ABC, CC
March 23–30	Receive and respond to second/third round of SEC comments	All
	File third/fourth amendment to Form S-1	ABC, CC, UC
	Publicly file registration statement and confidential submissions at least 15 days prior to when roadshow presentations with investors begin (on or before March 27 on this timeline)	ABC, CC
	Finalize roadshow presentation	ABC, U
	Set price range	ABC, U
	Custody agreement and powers of attorney drafted if there are selling shareholders (selling shareholder counsel is also involved in this activity)	ABC, U
March 30	Board approves such matters as deemed necessary in connection with the offering (including any pre-IPO transactions, such as stock splits or reorganizations)	ABC, CC
March 31	Distribute red herring	ABC, U

Detailed schedule

Date	Activity	Responsibilities
April 1–5	Roadshow presentations to underwriters	ABC, U
	Complete selling holder documents	ABC, T
	Complete company information form	ABC, T
April 10–18	Roadshow	ABC, U
April 12–17	Finalize FINRA review and receive “No Objection Letter” from FINRA	UC
	Draft original issuance instructions	ABC, T
April 17	File acceleration requests with SEC	ABC, CC, U, UC
April 17	File Form 8-A with the SEC	ABC, CC
	File Form 3 for officers and directors	
April 18	Registration statement declared effective by SEC	
	Pricing agreed upon and approved by ABC Pricing committee; Underwriting agreement signed	ABC, U
	Comfort letter delivered	A
	Sales activities commence	U
	QUIET PERIOD ENDS	
	POST-EFFECTIVE PERIOD	
April 19	Funds schedule and full wire instructions prepared	ABC, U, T
	Closing documents for review at least two days prior to closing	ABC, U, T
April 22	Final review of closing documents (evening before or morning of closing)	ABC, U, T
	Closing	All
	POST-CLOSING FILINGS	
Due within 40 or 45 days (depending on filer category) of the end of each of the first three fiscal quarters*	File Form 10-Q	ABC, A, CC
Due within 60, 75, or 90 days (depending on filer category) from end of fiscal year ending after effectiveness of IPO*	File Form 10-K	ABC, A, CC

Detailed schedule		
Date	Activity	Responsibilities
Typically due within four business days of the triggering event but varies based on nature of triggering event	File Form 8-K (to provide information on certain specified current material events)	ABC, CC
Timing dependent on Form S-8 applicability	File Form S-8 if applicable (to register securities that will be offered via benefit plans)	ABC, CC

*IPO issuers are nonaccelerated filers during the first year following their IPO irrespective of their publicly floated equity. Accordingly, the first report on Form 10-K will be due 90 days after fiscal year end. Thereafter, the company must determine filing deadlines based on its SEC-designated filer status (larger accelerated filer, accelerated filer, or smaller reporting company) determined by the worldwide public float as of the last business day of its most recently completed fiscal quarter. Filing deadlines referenced above will vary depending on the category of filer. See table 9-1 in Chapter 9 for filing deadlines.

Appendix E:

A sample due diligence checklist

I. Financial information

- A. Annual and quarterly financial information for the past three years
 - 1. Income statements, balance sheets, cash flows, and footnotes
 - 2. Planned versus actual results
 - 3. Management financial reports
 - 4. Breakdown of sales and gross profit by:
 - 5. Product type
 - 6. Channel
 - 7. Geography
 - 8. Current backlog by customer (if any)
 - 9. Accounts receivable aging schedule
 - 10. Inventory valuation, including turnover statistics and obsolescence analyses
- B. Financial projections
 - 1. Quarterly financial projections for the next three fiscal years
 - 2. Revenue by product type, customers, and channel
 - 3. Full income statements, balance sheets, and cash flow statements
 - 4. Major growth drivers and prospects
 - 5. Predictability of business
 - 6. Business plan, if available
 - 7. Risks attendant to foreign operations (e.g., exchange rate fluctuation, government instability)
 - 8. Industry and company pricing policies
 - 9. Economic assumptions underlying projections (different scenarios based on price and market fluctuations)
 - 10. Explanation of projected capital expenditures, depreciation, and working capital requirements
 - 11. External financing arrangement assumption
 - 12. Budgets
- C. Capital structure
 - 1. Current shares outstanding
 - 2. Schedule of all options, warrants, rights, and any other potentially dilutive securities with exercise prices and vesting provisions

- 3. Summary of all debt instruments/bank lines with key terms and conditions
- 4. Off-balance-sheet liabilities
- 5. Schedule of number of shares held in treasury
- D. Other financial information
 - 1. Taxes
 - a. Summary of current federal, state, and foreign tax positions, including net operating loss carryforwards
 - b. Federal, state, local, and foreign tax returns for last five fiscal years
 - c. A description of all audits by any federal, state, local, or foreign taxing authorities, including the date and a summary of each audit
 - d. All tax elections filed by the company or any subsidiary
 - e. All legal or accounting tax opinions received by the company or any subsidiary during the last five calendar years from outside advisers that relate to any tax reporting matters
 - f. Legal entity and product or service structures in place
 - g. Transfer pricing and other intercompany agreements
 - 2. General accounting policies (revenue recognition, etc.)
 - 3. Schedule of financing history for equity, warrants, and debt (date, investors, dollar investment, percentage ownership, implied valuation, and current basis for each round)

II. Products

- A. Description of each product (including product literature)
 - 1. Major customers and applications
 - 2. Historical and projected growth rates
 - 3. Market share
 - 4. Speed and nature of technological change
 - 5. Timing of new products, product enhancements
 - 6. Cost structure and profitability

- B. Product warranties and liability issues
 - 1. A description of all product warranties relating to any products developed or sold by the company or any subsidiary
 - 2. Explanation of any product recalls in last five years

III. Customer information

- A. List of significant customers for the past two fiscal years and current year to date by application (contact name, address, phone number, product(s) owned, and timing of purchase(s))
- B. List of strategic relationships (contact name, phone number, revenue contribution, and marketing agreements)
- C. Revenue by customer (name, contact name, phone number for any customers accounting for 5 percent or more of revenue)
- D. Brief description of any significant relationships severed within the last two years
- E. List of top 10 suppliers for the past two fiscal years and current year to date with contact information

IV. Competition

- A. Description of the competitive landscape within each market segment, including:
 - 1. Market position and related strengths and weaknesses as perceived in the marketplace
 - 2. Basis of competition (e.g., price, service, technology, and distribution)

V. Marketing, sales, and distribution

- A. Strategy and implementation
 - 1. Discussion of domestic and international distribution channels, including any value added resellers or original equipment manufacturers

- 2. Positioning of the company and its products
- 3. Marketing opportunities/marketing risks
- 4. Description of marketing programs and examples of recent marketing/product/investor relations/media information on the company
- B. Major customers
 - 1. Status and trends of relationships
 - 2. Prospects for future growth and development
 - 3. Pipeline analysis
- C. Principal avenues for generating new business
- D. Sales force productivity model
 - 1. Compensation
 - 2. Quota average
 - 3. Sales cycle
 - 4. Plan for new hires
- E. Ability to implement marketing plan with current and projected budgets

VI. Research and development (R&D)

- A. Description of R&D organization
 - 1. Strategy
 - 2. Key personnel
 - 3. Major activities
- B. New product pipeline
 - 1. Status and timing
 - 2. Cost of development
 - 3. Critical technology necessary for implementation
 - 4. Risks

VII. Operations

- A. List of properties
- B. Summary of supply chain, risks, and contingency plans
- C. History of any business interruptions

VIII. Management and personnel

- A. Organization chart
- B. Historical and projected headcount by function and location

- C. Summary biographies of senior management, including employment history, age, service with the company, years in current position
- D. List of board members, biographies, and compensation arrangements
- E. Compensation arrangements
 - 1. Copies of key employment agreements
 - 2. Benefit plans
- F. Discussion of incentive stock plans
- G. Significant employee relations problems, past or present; labor contracts
- H. Personnel turnover
 - 1. Data for the last two years
 - 2. Key unfilled vacancies
- I. Completed directors' and officers' questionnaires

IX. Legal and other matters

- A. Pending lawsuits against the company, detail on claimant, claimed damages, brief history, status, anticipated outcome, and name of the company's counsel
- B. Pending lawsuits initiated by the company—detail on defendant, claimed damages, brief history, status, anticipated outcome, and the name of company's counsel
- C. Description of environmental and employee safety issues and liabilities
 - 1. Safety precautions
 - 2. New regulations and their consequences
- D. List of material patents, copyrights, licenses, and trademarks—issued and pending
- E. Summary of insurance coverage/any material exposures
- F. Summary of material contracts
- G. History of SEC or other regulatory agency problem, if any, and all correspondence with regulatory agencies

- H. Organization and standing
 - 1. Articles of incorporation, including amendments
 - 2. Current bylaws
 - 3. Board committee charters
 - 4. Corporate minute books
 - 5. A list of all jurisdictions in which the company or any subsidiary owns or leases assets (including real property), has employees, or is qualified to do business as a foreign corporation
 - 6. A list of all current and former subsidiaries of the company
 - 7. Internet domain names, website linking, affiliate, cobranding, content provider, and other e-commerce agreements
 - 8. Noncompetition, exclusivity, on-solicitation and indemnification, and license agreements in favor of the company or by which the company is bound
 - 9. Patents, trademarks, copyrights, and other evidence of intangible property
 - 10. A schedule of significant fixed assets, owned or used by the company, including the person holding title to such assets and any material liens or restrictions on such assets

X. Other company information

- A. List of all shareholders with shareholdings, options, warrants, or notes
- B. Schedule of officers, directors, and committees of the board
- C. Press releases relating to the company, its management, or its products and services
- D. Shareholder agreements, proxies, and voting trusts
- E. Schedule of ownership by officers, employees, and directors
 - 1. Any analyst reports covering the company or industry generally

Appendix F:

Emerging growth companies

Definition	An issuer that had total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year.
EGC duration	<p>An issuer that is an EGC continues to maintain its EGC status until the earliest of:</p> <ul style="list-style-type: none"> • The last day of the fiscal year during which it had total annual gross revenues of at least \$1.07 billion; • The last day of the fiscal year following the fifth anniversary of the initial public offering of its equity (IPO); • The date on which it has, during the previous three-year period, issued more than \$1 billion in nonconvertible debt; or • The date on which it is considered to be a “large accelerated filer” under the Exchange Act (meaning the issuer has been reporting for at least one year, has filed at least one annual report, and the value of its common equity held by nonaffiliates is at least US \$700 million, calculated on the last business day of its most recently completed fiscal quarter).
Status determination	<p>During the IPO process, an issuer should test its status as an EGC at the time of the first public filing of its IPO registration statement with the SEC. An issuer that qualified as an EGC at the time it confidentially submitted its draft registration statement (or, alternatively, publicly filed its registration statement) but loses its status during the IPO process, can retain its EGC status through the earlier of:</p> <ul style="list-style-type: none"> • the date of the consummation of the IPO, or • the end of a one-year period beginning on the date the issuer lost its EGC status.
EGC benefits include	<ul style="list-style-type: none"> • Reduced financial information in SEC filings <ul style="list-style-type: none"> – An EGC is permitted to present only two years of audited financial statements in its registration statement, as compared to the three years required for non-EGCs. An EGC also may limit the number of years of selected financial data to two years. • Delayed compliance with auditor attestation on internal controls required by Section 404 of Sarbanes-Oxley • Deferred compliance with new or revised accounting standards • Reduced executive compensation disclosure <ul style="list-style-type: none"> – An EGC may (1) omit the detailed Compensation Discussion and Analysis; (2) provide compensation disclosure covering the top three (including the CEO), rather than the top five, executive officers; and (3) omit four of the six executive compensation tables required for larger companies. • Exempt from say-on-pay shareholder votes • Publication and distribution of research reports



Glossary

Acceleration. Procedure in which the SEC declares a registration statement effective, waiving the statutory 20-day waiting period.

Accelerated filer. An issuer after it first meets the following conditions at the end of its fiscal year: (1) public float of \$75 million or more but less than \$700 million at the end of its most recently completed second fiscal quarter; subject to the filing requirements of the 1934 Act for at least 12 months; and at least one annual report filed under the 1934 Act. As of June 2018, a smaller reporting company may also qualify as an accelerated filer.

Accredited investor. The SEC designation for an individual or entity meeting certain strict criteria specified in Regulation D. Certain restricted offerings are open only to accredited investors.

Aftermarket. Trading activity in a security immediately following its IPO.

Agreement among underwriters. An agreement signed by the members of the underwriting syndicate empowering the lead underwriter to sign an underwriting agreement with the company selling the stock (issuer). This is now generally accomplished electronically through a standardized document.

All hands meeting. A meeting of all the parties involved in preparing the registration statement (normally company management, company counsel, underwriters, underwriters' counsel, and auditors).

American depository receipts (ADRs). Securities issued by a US bank that represent foreign shares held in custody by that bank, thereby facilitating the trading of foreign shares in US markets.

Analyst. An individual who studies the development of individual companies or industries for the purpose of advising investors; also called financial analyst or securities analyst.

Best efforts. An underwriting agreement in which the underwriters agree to use their "best" efforts to sell the issue (without any up-front financial commitment), acting only as agents of the issuer.

Bid and asked. The quoted prices for trading in the OTC market. The bid is the highest price someone is willing to pay; the asked is the lowest price at which someone will sell.

Blue Sky Laws. A popular name for the various states' securities laws and regulations that have been enacted to regulate the offering and sales of securities in that particular state, as well as the registration and reporting requirements for broker-dealers and investment advisers in the states. The National Securities Markets Improvement Act (NSMIA) created categories of securities, which preempts many IPOs from the state securities registration requirements of the Blue Sky Laws.

Bring-down comfort letter. The update to the comfort letter issued by the company's auditors as a condition of closing an offering. The bring-down letter reaffirms the detailed comfort letter issued when the registration statement becomes effective.

Broker. An individual or firm that acts as an intermediary between a buyer and a seller, usually charging a commission.

Broker-dealer. An individual or firm in the business of buying and selling securities for itself and others. When acting as a broker, a broker-dealer executes orders on behalf of its clients. When acting as a dealer, a broker-dealer executes trades for its firm's own account, for which such securities may be sold to clients or other firms or become a part of the firm's holdings.

Capitalization. The total amount of the various securities issued by a company. For registration-statement purposes, capitalization includes all short- and long-term debt and shareholders' equity.

Closing. A meeting at the conclusion of an offering, held for the purpose of completing the issuance and sale of the stock. It includes delivery of funds for the net proceeds of the offering, as well as a number of documents, including certifications, legal opinions, and a bring-down comfort letter.

Comfort letter. A letter provided by the auditors to the underwriters, indicating the results of agreed-upon procedures performed on financial data included in the registration statement (other than the audited financial statements), as requested by the underwriters.

Confidential Submission. Process whereby an issuer can privately submit, as opposed to publicly file, its registration statement and successive amendments to the SEC. Should an issuer decide to go public, these documents must be publicly filed at least 15 days before the start of any roadshow.

Confidential treatment. The method whereby a company can request that certain sensitive or confidential information contained in exhibits to filings made with the SEC be redacted from the documents and not made available to the public.

Dealers. Individuals or firms in the securities business who buy securities for their own account and sell to customers from inventory.

Depository Trust Company (DTC). A securities depository that provides clearing and settlement services to securities brokers and dealers, banks, trust companies, clearing companies, and other DTC participants to hold their securities and to facilitate transfers of such securities through electronic book-entry changes. (Book-entry means the company's transfer agent maintains your shares on your behalf without the need for physical share certificates. Shares held in uncertificated book-entry form have the same rights and privileges as shares held in certificate form.)

Dilution. The reduction of one’s relative equity interest; the sale of additional shares dilutes the percentage of one’s ownership. Also, a disclosure in the registration statement comparing the offering price to the tangible book value per share of the company’s stock before and after the offering.

Directors’ and officers’ questionnaires. Questionnaires circulated by the company’s counsel and underwriters’ counsel before registration. The questionnaires verify information about the directors and officers that is to be disclosed in the registration statement.

Direct Registration System (DRS). A service offered by the depository trust company, which enables the registered shareholders to maintain and transfer their shares on the books and records of the transfer agent in book-entry form instead of a physical stock certificate.

Dodd-Frank Wall Street Reform and Consumer Protection Act. Signed into law on July 21, 2010, the Dodd-Frank Act was a response to the 2007–2010 financial crisis. The act was passed to promote the financial stability of the United States and prevent another significant financial crisis by creating new financial regulatory agencies and processes that enforce transparency and accountability while implementing rules for consumer protection.

Domestic issuer. An issuer other than a FPI.

Due diligence. An investigation conducted by the parties involved in preparing a registration statement to form a reasonable basis for believing that the statements contained therein are true and that no material facts are omitted.

Effective date. The date on which the registration statement is declared effective by the SEC and the sale of securities pursuant to the registration statement can commence.

Electronic Data Gathering, Analysis, and Retrieval (EDGAR). An electronic system developed by the SEC that allows companies to file electronically SEC documents. The site can be visited via the SEC’s website at www.sec.gov.

Emerging growth company (EGC). An issuer with total annual gross revenues of less than \$1 billion during its most recently completed fiscal year.

Financial printer. A printer that specializes in the printing of financial documents, including prospectuses and registration statements.

The Financial Industry Regulatory Authority (FINRA). The largest self-regulatory organization for the securities industry in the United States, FINRA provides oversight of brokerage firms. It also performs market regulation under contract for, among others, Nasdaq. FINRA’s Corporate Finance Department reviews underwriters’ compensation to determine whether underwriting agreements are fair and reasonable.

Firm commitment. An underwriting agreement in which the underwriters agree to buy the entire issue and then resell it.

Foreign Corrupt Practices Act (FCPA). A federal law, which includes provisions within the 1934 Act, that requires companies to maintain adequate records and systems of internal control with regard to certain foreign payments. It also prohibits bribery of foreign governmental officials in order to obtain or retain business.

Foreign private issuer (FPI). A company that is incorporated or organized under the laws of a foreign country, except an issuer meeting the following conditions: (1) more than 50 percent of the issuer’s outstanding voting securities are directly or indirectly held by residents of the United States, and (2) any of the following: (a) the majority of the executive officers and directors are US citizens or residents; (b) more than 50 percent of the assets of the

issuer are located in the United States; or (c) the business of the issuer is administered principally in the United States.

Form 8-K. Current report required to be filed with the SEC by most domestic companies when specific material events or corporate changes occur.

Form F-1. Basic registration form used to register securities by FPIs.

Form S-1. The most commonly used SEC form for registering securities in an IPO.

Form 6-K. Current report required to be furnished by foreign private issuers with the SEC for reporting material information that is either (1) distributed to shareholders or filed with a foreign stock exchange, if made public by that exchange; or (2) required to be made public by its domestic laws.

Form 8-A. The registration form to register a class of securities under the 1934 Act to allow trading to occur.

Form 10-K. Annual report required to be filed with the SEC by domestic companies in compliance with the 1934 Act.

Form 10-Q. Quarterly report, containing primarily unaudited quarterly financial information, which must be filed by domestic companies with the SEC in compliance with the 1934 Act.

Form 20-F. Unlike other SEC forms, this form is both a registration statement and an annual report form used by foreign private issuers under the 1934 Act.

Free writing prospectus. Written communications that constitute offers to sell or a solicitation of an offer to buy the issuer’s securities after the filing of a registration statement other than the statutory prospectus or certain post-effective communications.

Gun jumping. Communications in advance of the filing of a registration statement designed to prepare or “condition” the market for the offering in violation of the 1933 Act.

International Financial Reporting Standards (IFRS). A set of accounting standards developed by the International Accounting Standards Board (IASB) used in many countries. The SEC currently allows FPIs to file reports using IFRS as an alternative to US GAAP.

Independent director. A member of the company’s board who is not an employee of the company or any subsidiary and who does not have a relationship which, in compliance with the requirements of the listing exchange independence rules and in the opinion of the company’s board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

Insider. Officer, director, or a 10 percent shareholder of a public company.

Institutional investor. A bank, mutual fund, pension fund, or other corporate entity that trades securities in large volumes.

Investment banker. The intermediary between the company issuing new securities and the investing public. Also known as an underwriter.

IPO. Initial public offering. An issuer’s first public distribution of a security.

Jumpstart Our Business Startups Act (JOBS Act). Signed into law on April 5, 2012, the law consists of a package of bills intended to make it easier for smaller companies to raise capital in the US financial markets.

Large accelerated filer. An issuer after it first meets the following conditions as of the end of its fiscal year: (1) public float of

\$700 million or more as of the last business day of its most recently completed second fiscal quarter; (2) subject to the filing requirements of the 1934 Act for at least 12 months; and (3) at least one annual report filed under the 1934 Act. As of June 2018, a smaller reporting company may also qualify as a large accelerated filer.

Lock-up agreement. An agreement with underwriters whereby the issuer and certain shareholders agree not to sell their shares in the company for a period of time after the effective date of a registration statement (usually lasting 180 days).

Making a market. Efforts by a dealer to maintain trading activity in a particular stock by offering firm bid and asked prices in that stock.

Management’s discussion and analysis (MD&A). A report from management to shareholders that accompanies the company’s financial statements in the annual report. It explains the period’s financial results and enables management to discuss topics that may not be apparent in the financial statements. For foreign issuers using Form 20-F/F-1, the MD&A is commonly known as the operating and financial review or OFR.

Market maker. A dealer who maintains firm bid and offering prices by standing ready to buy or sell at publicly quoted prices in a particular security.

Material information. Refers to information that a reasonably prudent investor would find of importance in making an investment decision.

Medallion signature guarantee. A stamp provided by an eligible guarantor institution (financial institutions, such as a bank, broker, credit union, or savings association) to guarantee the genuineness of the shareholder’s signature in connection with the transfer of securities.

Nasdaq. Nasdaq is the world’s largest computer-based stock market; it includes the Nasdaq Global Select Market, Nasdaq Global Market, and the Nasdaq Capital Market.

Nonaccelerated filer. An issuer that does not meet the definition of an accelerated filer or a large accelerated filer.

NYSE. Founded in 1792, New York Stock Exchange is the largest organized securities market in the United States.

Over-allotment. An option in a firm commitment underwriting agreement allowing the underwriters to purchase additional shares than what is required under the underwriting agreement. Also known as a “greenshoe.” FINRA rules limit the over-allotment option to no more than 15 percent of the total offering.

Over-the-counter (OTC) market. A securities market made up of dealers who buy and sell securities not listed on an exchange. The dealers in the OTC market are linked by telephones and computer screens.

Partial secondary offering. An offering in which securities are offered for sale by both the company and existing shareholders.

Price-earnings ratio. A measurement of stock value calculated by dividing the price per share of common stock by earnings per share.

Private placement. An offering of securities exempt from registration, which is limited in distribution.

Private Securities Litigation Reform Act of 1995 (PSLRA). Legislation passed by Congress in 1995 to stem the filing of frivolous or unwarranted securities lawsuits. The PSLRA increased the amount of evidence plaintiffs were required to have before filing a securities fraud case with the federal courts. It also changed the way

securities class action lawsuits were handled by giving judges the authority to determine plaintiffs and to take other actions to reduce legal system abuses.

Prospectus. The official document included in the registration statement filed with the SEC, used as the selling document in an offering that discloses pertinent information regarding the issuer and the securities being sold. It must be given (or deemed given) to original purchasers of the security no later than the confirmation of their purchase.

Proxy solicitation. The request to be authorized to vote on someone else’s behalf. A proxy statement must be furnished to shareholders before soliciting their proxies.

Proxy statement. A document that the SEC requires a company to send to its shareholders, which provides material facts concerning matters on which the shareholders will vote.

Public Company Accounting Oversight Board (PCAOB). A private sector, nonprofit corporation, created by SOX, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

Public float. The aggregate worldwide market value of the issuer’s outstanding voting and nonvoting common equity held by nonaffiliates.

Qualified institutional buyer (QIB). A purchaser of securities that is deemed financially sophisticated and is legally recognized by security market regulators to need less protection from issuers than most public investors. QIB primarily refers to an institution that manages at least \$100 million in securities from issuers not affiliated with the institution. Also included are registered broker-dealers owning and investing, on a discretionary basis, \$10 million in securities of nonaffiliates.

Quiet period. Generally, the period between the time the registration statement is filed and the effective date, so called because of the restrictions on publicity. There are also restrictions on publicity both before and after the quiet period, also known as the waiting period. Certain excepted communications, such as “testing the waters” communications, are permitted during the quiet period.

Red herring. The preliminary prospectus, circulated during the waiting period, which bears a legend in red ink stating that the registration statement has not yet become effective.

Registrar. An agency that issues certificates to new shareholders and verifies the transfers of stock to make sure that the number of new shares issued is the same as the number of shares canceled.

Registration. The administrative procedure for filing information required under the 1933 Act.

Registration statement. A document filed with the SEC to register securities under the 1933 Act. The registration statement (e.g., Form S-1) comprises the prospectus and other information not required in the prospectus.

Regulation D. Provisions of the 1933 Act that contain rules governing certain private-placement offerings.

Regulation fair disclosure (FD). The rule governing selective disclosure by issuers of material nonpublic information, requiring that when an issuer or person acting on its behalf discloses material nonpublic information to certain enumerated persons, it must disclose that information simultaneously for intentional disclosures or promptly for nonintentional disclosures by a method or methods reasonably designed to effect broad, nonexclusionary distribution of the information to the public.

Regulation S-K. The primary integrated disclosure rules for preparing the portions (other than the financial statements) of forms filed under the 1933 and 1934 Acts.

Regulation S-X. The primary rules governing the preparation of the financial statements in forms filed under the 1933 and 1934 Acts.

Restricted stock. Securities, usually issued in a private placement, that have limited transferability. Also called legended stock or letter stock.

Roadshow. A series of presentations by company executives during the waiting period, for the purpose of introducing the company and its management to potential investors, analysts, and underwriters.

Rule 144. An exemption provided in the 1933 Act that allows, under certain conditions, the resale of restricted stock by any person and other stock by controlling persons in the public market without registration of that stock.

Rule 144A. An exemption provision of the 1933 Act that provides a “safe harbor,” under certain conditions, for resales of securities to certain qualified institutional buyers, as defined in Rule 144A.

Sarbanes-Oxley Act of 2002 (SOX). Congress-enacted reforms aimed at restoring investor confidence, which hold public companies to a higher standard of corporate governance than in the past.

SEC. The Securities and Exchange Commission is a federal agency created by the 1934 Act to administer federal securities laws.

Secondary offering. An offering in which securities of previously unregistered stock are offered for sale by existing shareholders.

Securities Act of 1933, as amended (1933 Act). Sets forth the disclosure and antifraud requirements for securities offered and sold in interstate commerce and through the mail.

Securities Exchange Act of 1934, as amended (1934 Act). Regulates and controls the securities markets and related practices and matters. Includes ongoing disclosure requirements and antifraud provisions.

Smaller reporting company. A company that meets all the following criteria: (1) is not an investment company, an asset-backed issuer, or the majority-owned subsidiary of a parent that is not a smaller reporting company; and (2) had a public float of less than \$250 million as of the last business day of its most recently completed second fiscal quarter or in the case of an IPO, as of the date within 30 days of the date of the filing of the registration statement, and in the case of an issuer whose public float was zero; or (3) had annual revenues of less than \$100 million and no public float, or a public float of less than \$700 million during its most recently completed fiscal year for which audited financial statements are available on the date of filing.

Stabilization. Attempts by the underwriters to stabilize prices during the distribution of a new issue, specifically through the purchase of securities for their own account when the market price is at a dip below the public offering price.

Syndicate. A group of investment bankers that, together, underwrite and distribute an offering of securities.

Tender offer. A formal offer to purchase shares of stock from existing shareholders, usually in connection with an attempt to gain control of the company.

Tombstone ad. An advertisement with limited information announcing an offering of securities and indicating where a copy of the prospectus can be obtained.

Transfer agent. An agency that keeps the official records of the names and addresses of a company's shareholders and handles the transfer of shares from one person to another.

Underwriter. See investment banker.

Underwriters' discount. A percentage of the gross proceeds of an IPO that constitutes the compensation paid to the underwriters for marketing and selling the offering.

Underwriting agreement. An agreement between a company and its underwriters setting forth the terms of the offering, including method of underwriting, the offering price, and commissions.

Waiting period. The period between the date the registration statement is initially filed with the SEC and the date it is declared effective.

Warrants. Certificates giving the holder the right to purchase securities at a stipulated price within a specified time limit or perpetually.

XBRL. A language for the electronic communication of business and financial data. SEC filers are required to add a "tag" to every numeric amount in the financial statements and to every numeric amount in the notes to the financial statements (but excluding MD&A or other disclosures).

About Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

Serving clients in every major international financial center, Skadden is one of the leading law firms in the world, with 22 offices and approximately 1,700 attorneys.

The Capital Markets Group at Skadden has advised on some of the largest and most complex initial public offerings worldwide. We also regularly represent companies of all sizes and underwriters in connection with smaller and midsize IPOs, including those of many emerging companies. We integrate members of our securities regulation and corporate governance practice in the early stages of the IPO

process to assist our clients with planning and preparing for post-IPO public company disclosure and governance requirements.

We consistently have been named one of the leading firms globally in capital markets by Chambers Global, Chambers USA, Chambers Latin America, Law360, Legal 500, IFLR1000, and U.S. News – Best Lawyers—with many of our attorneys individually identified as leaders in the area of capital markets. Skadden has been named the top US firm in Corporate Board Member magazine's annual survey of "America's Best Corporate Law Firms" more than any other firm.

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Deloitte offers a dedicated group of professionals with extensive IPO experience across all industries. We offer fully integrated, customized solutions and provide accounting, financial reporting, and technology short-term deliverables and long-term solutions. We can call on our deep and diverse experience to tailor an approach to help you address your specific needs in preparing for your IPO—no matter what your company's level of readiness.

Our access to the resources of the member firms of Deloitte Touche Tohmatsu Limited enables us to deliver quality services on a global scale, including accounting, financial reporting, tax, and technology, through a network of professionals located in business centers around the world. Deloitte's Controllershship practice offers vast experience and a strong track record with US GAAP, IFRS, and regulatory filings (SEC and other regulatory agencies). This enables us to assist with a broad set of issues wherever you operate in the world, as well as help you explore options to list on both domestic and foreign exchanges.

The Deloitte Center for Board Effectiveness (the Center) assists executives, boards of directors, and others active in governance by providing them with resources pertaining to current boardroom issues and governance trends. The Center's activities demonstrate its focus to encourage dialogue, knowledge sharing, and collaboration among corporations, board members, the accounting profession, academia, and government.

Deloitte's Accounting Standards & Communications practice helps organizations stay informed on the latest developments within the accounting profession, offering a variety of information resources on accounting standards, financial reporting, regulatory updates, and technical trends. Resources include timely newsletters; special

reports; an ongoing webcast series called Dbriefs for Financial Executives; and the highly acclaimed Technical Library, the Deloitte accounting research tool. Our experienced professionals are distinguished in the accounting profession—many have held positions with organizations such as the SEC and the Financial Accounting Standards Board.

Links to relevant sites

In addition to this publication, Deloitte has a range of publications to assist with IPO-related matters, legislative changes to the IPO process, and accounting standards related to IPO filings. These publications can be found at the websites listed below.

For more information on Controllershship, [click here](#).

For more information on the Center for Board Effectiveness, [click here](#).

For more information on Accounting Standards & Communications, [click here](#).

Additional Resources

A roadmap to initial public offerings (2018)

Deloitte's entire roadmap series

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