Excellence in Financial Management

Course 13: Going Public

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This course provides an overview of how a company goes public through an Initial Public Offering or IPO. This course is recommended for 2 hours of Continuing Professional Education. In order to receive credit, you will need to pass a multiple - choice exam, which is administered by downloading and installing the exe file version of this course. The exe file is located on the internet at www.exinfm.com/training

NOTE: This short course includes supplemental materials. You can download supplemental materials over the internet at www.exinfm.com/training.

Chapter

1

Preliminary Considerations

There are millions of privately held companies throughout the United States and the World. Very few of these privately held companies will graduate from the minor leagues of business (privately held) to the major league of business (publicly held). This transformation from the minor league to the big league in business is called "going public" and it culminates when the company can finally sell its stock to the public; referred to as an Initial Public Offering or IPO. As with any major business transformation, going public requires extensive planning, preparation, and perseverance. This short course will outline the IPO process and some of the critical issues that a privately held company must address for successfully going public. We will divide the process into three phases, all of which tend to be somewhat concurrent (taking place over similar time frames):

- Preparing for the IPO
- Registering the IPO
- Selling the IPO

> "Many business owners view the possibility of an Initial Public Offering (IPO) of their company's stock as the ultimate dream – the fulfillment of years of hard work, expressed in terms of wealth, prestige, recognition, and power. To others, that dream represents a nightmare – something to be feared and avoided at all costs, even at the expense of restricting the growth and potential of their company. In reality, the successful public sale of a part of the equity of your company is neither a fantasy nor a nightmare, but rather the objective of a strategic business decision made after detailed consideration of all the pros and cons. Like most business decisions, the earlier you plan and more prepared you are, the better the results."
>
> - Going Public: How to Make Your Initial Stock Offering Successful by Martin Weiss

Critical Questions

Transforming a private company into a publicly listed company is an exhaustive and grueling process, requiring a massive effort in a relatively short period of time. In their book Initial Public Offering: A Strategic Planner for Raising Equity Capital, authors David P. Sutton and M. William Benedetto pose the following critical question: *Is Public Ownership Right for You?*

- Proper Fit: Are you truly independent and free of conflicts of interest? Can you survive being public, not imposing undue restrictions on the company? Can you honestly and easily explain all major problems and issues of your business to a very probing and analytical investment community? Do you have solid agreement from independent sources (directors, auditors, large customers, etc.) that going public is the right thing to do?

- Sharing of Ownership: Are you able to separate your company from your own personal identity? Can you accept the fact that some day you may get forced out of the company you helped to create? Can you accept compensation set by a board and disclosed to the public? Can you tolerate a board that outvotes you on certain issues?
- Investor Appeal: Will investors quickly understand your business model? Can investors perceive long-term value and growth by investing in your company? Do you have positive feedback that key people who you know would be willing to purchase stock in your company? Can you identify groups of people who will have an interest in purchasing shares of stock? Are you willing to price your stock at a discount in relation to competing public companies, so as to attract investor interest?
- Amount Raised: Do you have a clear idea of how much capital you need to raise in a public offering? Do you have some idea of how much ownership you are willing to relinquish? Do you know how you will use the proceeds from the public offering?
- Purpose and Timing: Is your company at the right development stage for a public offering? Can you forecast your business plan out for the next several years? Do you have a forecast that identifies your next stage of financing after the IPO and how you will raise this additional capital?

> "An Initial Public Offering is a legal process in which a company registers its securities with the Securities and Exchange Commission (SEC) for sale to the general investing public. Many entrepreneurs view the process of going public as the epitome of financial success and reward; however the decision to go public requires considerable strategic planning and analysis from both legal and business perspectives. The planning and analysis process involves: weighing the costs and benefits; understanding the obligations of the company, its advisors and its shareholders once the company has successfully completed its public offering."
>
> - Raising Capital: Get the Money You Need to Grow Your Business by Andrew J. Sherman

It is also important to understand some of the advantages and disadvantages of going public:

Advantages to Going Public:

1. Broader access to raising capital leading to increased financial stability. By going public, you tap into the single biggest source of capital in the United States. And one third of all companies that go public do a secondary offering within the first five years of going public; so for growing companies, this is a critical source of capital.
2. Establishes a market price for the company. This can be important for "marketing" the company. Owners often try to market the company as a way of generating a return for those (owners, venture capitalist, etc.) who initially funded the company. Becoming "liquid" is a big reason for going public – investors need to get paid back.
3. Securing long-term customer relationships. Customers want to do business with a company that will be around for the long-haul. Public companies are viewed as long-term providers of services and products.

4. Cheap source of capital – For private companies with debt, equity markets provide a much cheaper source of capital since no interest payments are required and there is no repayment of principal.

Disadvantages to Going Public:

1. Intense scrutiny from shareholders and the investment community. Management will be under intense pressure to deliver growth and strong earnings.
2. Much more disclosure than before. Disclosures include possible lawsuits, financial losses, criminal actions, etc.
3. Loss of control - Once pubic, the company could be a victim of a hostile takeover.
4. Costs of Public Company – Public companies have initial and recurring costs, such as annual audit fees, increased payroll costs for financial personnel, public relations, director liability insurance, and other costs unique to a public company.
5. Restrictions on Stock Trading – Stock sales are restricted under Rule 144. Insiders who hold stock cannot sell the stock after the IPO. Underwriters will also impose certain lock-out provisions, restricting stock sales.
6. Time – The minimum time required for going public is approximately six months and many successful IPO's (Initial Public Offerings) take over one year. In cases where the market is down and the company is poorly organized for public life, the IPO can take several years.

Key Point ► Consider the impact of Sarbanes-Oxley Act of 2002

The costs of being a public company have almost doubled as a result of the Sarbanes-Oxley Act of 2002. Additional disclosures, internal controls, legal council, higher audit fees, and other costs are now part of how publicly traded companies must function. As a result, some publicly traded companies are opting out from SEC disclosures through Form 15 (no more than 300 shareholders of record). Other companies are going private through tender offers of their stock, realizing that running a public company is too costly. Make sure you understand the impact of recent legislation.

"To go public, you have to have a successful business model that's going to survive over the long pull. Strong brands generally have that. Normally, a strong consumer brand or a strong business brand has value under any circumstance. So we look hard in the branded area.

You also must have people with business sense. It's the vision of management, more than anything else, that determines how a company is going to do. Good management comes in very different packages, and what you have to do, of course, is to look at the key players' record, their background. Are they people who know how to run businesses? And if they're real young, it can be a real problem – the way it was in the Internet space. Many of the really good ideas were generated by the young technology people. But they just didn't know how to run a business "

- An IPO for Everyone by Udayan Gupta, Inc Magazine, September 2001

The Right Stuff

Once we have addressed the basic questions, we need to do a major reality check. This "reality check" is based on comparing the company against other successful IPOs. If we can measure up against other successful public companies, then we can honestly consider going public.

So what are the critical characteristics for successful IPO candidates? Here are some basic benchmarks:

- Great Management Team – The management of the privately held company must have a passion for growing the business with a proven track record of results.
- Consistent Long-Term Growth – The company is demonstrating consistent sustainable growth and if given additional capital, higher levels of growth are obtainable.
- Outperforming the Competition – The privately held company is clearly outperforming the competition.
- Outstanding Business Model – A business model that works and has been tested against the marketplace over time, backed up by solid financial performance.
- Product and Service Lines are Well Defined – Growing market demand for products and services.
- Strong Reputation – The company should have an "established presence" with major stakeholders (customers, industry analyst, etc.). Market awareness and recognition are critical; otherwise additional capital may not leverage the "intangible" strength's of the company. Relationships with investment bankers should be in place long before you go public.
- Minimal conflicts of interest – Related party transactions, family members serving on the Board and other apparent conflicts will unravel your IPO; especially when the legal council starts to do their due diligence. Therefore, you may have to "cleanse" your corporate soul before going public.
- Simple capital structure – Avoid complicated capital structures with various types of convertible securities. This will raise a red flag to investors about possible dilution.

A Tougher View of IPOs

One last reality check is to look at the long-term performance of IPOs. According to Yobie Benjamin of Ernst & Young, 7 of every 10 start-up companies fail before they reach their IPO. The truth is that most companies with successful IPOs have been around at least five years. Only about one-third of companies going public are start-up companies. And according to a McKinsey & Company survey of some 230 IPOs in 1991 and 2000, a mere 8% of all IPOs were competitive in relation to values and prices offered by industry peers. The point is simple – you must have strong control over the fundamentals of your business if you expect to be successful with an IPO since once a company goes public, an immediate acceleration period kicks-in. And if your people, processes, infrastructure, and other business components are not solid, then your market performance will not measure up against industry peers.

Keep in mind that most companies that start the IPO journey never make it. Too many things derail the process:

- Key management personnel resign
- Market conditions change
- Products and services fall out of favor
- Business strategy no longer holds up against the competition

Perhaps one of the biggest problems has to do with culture. Going pubic is a transformation of corporate culture and cultural change is extremely difficult.

> "Going public today is a process I wouldn't wish upon my worst enemy. It has become too difficult for companies to go public. While there was probably too much trust three to four years ago, now the pendulum has swung too far in the opposite direction. I think that as a result, we're going to see significantly fewer private firms issuing IPOs."
>
> - Peter Thiel, former CEO of PayPal, The Risky Business of Going Public by Helen K. Chang

Key Point ► It helps to have executive management that enjoys being public

Some CEO's are not made for the rigors of being public while others enjoy running a publicly traded company. Ultimately, if you have the wrong type management, you will never have the right image as a publicly traded company. Make sure senior management is comfortable "singing for its supper" in the public arena. If you have this kind of management, then you have the makings of a public company.

Chapter

2

Preparing for the IPO

If you plan to make it across the IPO Finish Line, then you will have to spend most of your time preparing to go public. Once a company makes the decision to go public, it should immediately start to change to a "public structure." A public structure transforms the company so that it begins to act and behave like a public company. This will require several initiatives:

- Coordination of private placements and other financing activities within the IPO timeline.
- Publication of regular, audited financial statements to document consistent and strong growth in earnings.
- Establishing an independent Board of Directors that balances the interest of management with the interest of investors.
- Securing the services of a Public Relations Firm with strong ties to the investment banking industry.
- Revising various corporate documents and policies (such as executive compensation) to mirror what publicly traded companies are doing.

> "Motivation is everything in building a company. A few founders are motivated purely by the goal of creating wealth. This can be an excellent incentive, but if it is the sole reason the founder creates the company, it does not usually produce the best results. In general, founders who are motivated purely by wealth often have a short-term view, leading them to make tactical rather than strategic decisions. Their companies may succeed in producing substantial short-term paycheck, but they generally do not develop into the kind of large and successful companies that create the greatest value for founders and investors over time."
>
> - Confessions of a Venture Capitalist by Ruthan Quidlen

One obvious area of concern with any IPO has to do with the management team. The character and quality of the management team is paramount to IPO success. Investors will be looking to see if management can grow the company. Were they able to grow companies in the past? Were they able to pull a company through tough times? Does the management team understand their business extremely well? Is the management team committed to running the company long after it goes public?

Key Point ► Management Team is what sells the IPO

Who runs a company is what sells the IPO. Investors expect to see very knowledgeable, experienced professionals who are committed to the long-term success of the company. They do not want to see a group of people on the verge of retirement nor do they want to see young, inexperienced people who are full of ideas, but clueless on running a business.

If you have weaknesses in management, then you will need to recruit very knowledgeable people who can fill these weaknesses. Former public officials, retired CEO's, and recognized business leaders are good choices for building the executive management team.

Another overlooked part of preparing for an IPO has to do with infrastructure. Public companies tend to have very elaborate internal control systems, accounting processes, financial reporting functions, internal auditors, and other support activities associated with a public infrastructure. Building this public infrastructure takes considerable time. If you wait to build this infrastructure just before going public, you will end-up paying expensive premium rates. It's best to start early since you need time to work out the bugs, establish relationships, and have audited financial statements ready to go for prior years (required as part of the registration statement).

Factors Triggering the Timing of Going Public

1. Capital Needed – Startup company needs large sums of capital, beyond the reach of a private placement.
2. Cheaper Cost – IPO will costs less than another round of venture capital.
3. Cash in Chips – Everyone wants to get liquid.
4. Large Enough – Startup company is large enough and profitable enough to go public.
5. Hot Stock Market – Stock market is hot and hungry for IPO's.
6. Prestige – Management, employees, investors, and others want the fame and glory of being associated with a highly successful company.
7. Number of Stockholders – Securities Exchange Commission (SEC) requires the shares of a private company to be registered when the number of shareholders reaches five hundred.

- Saratoga Venture Finance

The IPO Team

Once you are well on your way to building a public structure, you will need to form an IPO Team. IPOs are time intensive with numerous activities all taking place at the same time: Public Relations Campaign, Due Diligence, Selecting the Underwriter, Preparing Audited Financial Statements, etc. A well-seasoned group of professionals will facilitate the IPO Process, consisting of:

- **Executive Management** – Senior level managers (such as the CEO and CFO) will need to own the IPO Process, directing, planning, and coordinating everyone else. It will be imperative to keep everyone on a very tight time schedule.
- **Legal Council** – Someone will have to ensure that all regulatory issues are adequately addressed; especially SEC requirements. Additionally, there are possible state laws related to the sale of securities. Legal council will make sure articles, by-laws, corporate charter, and other documents are changed to comply with both state and federal security laws. Legal council will also help negotiate the underwriting agreement and execute due diligence.

- **Underwriter / Investment Bankers** – Bankers must be used to underwrite and sell the public offering. Investment bankers will also use their own legal council to perform due diligence. You should start shopping around for underwriters at least one year before going public. Some critical issues to consider when selecting an underwriter are:
    - Past experience with other public offerings, similar size and same industry.
    - Past performance, how close were they in final pricing of the stock, how did the stock hold up in the after market, what support was provided during and after the company went public, etc.
    - References – Contact past clients of the Underwriter.
- **SEC Accounting / Financial** – Financial disclosures are a big part of going public. You will need someone to coordinate SEC filing and reporting requirements. A functional group must be in place to meet regular registration requirements. Don't be surprised if you have to meet your first 10-Q filing within 45 days of going public.
- **Independent Auditor** – Financial statements must be audited. Select a large public accounting firm with past experience with SEC Filing and Reporting Requirements. Auditors should offer recommendations on IPO related issues. For example, alternative financing plans should be explored since there is a real risk that the company may not be able to go public. One of the primary roles of the Auditor is to ensure that controls and procedures are well-established. This is the foundation for financial reporting and disclosure to the SEC. Retain auditor's early-on so they can complete internal control reviews and financial statement adjustments long before the critical deadlines hit.
- **Public Relations** – A company going public must present itself just like a public company. This will require a public relations effort. And if you want to attract investors, it helps to have a PR firm connected and experienced with investor related issues. The Public Relations (PR) Firm will help manage various issues within the investment community. PR Professionals will coach the executive management team on how to handle tough questions. They will develop a strong corporate image for the company. The PR Firm will issue press releases and coordinate the road show (intense tour before potential investors), leading up to the IPO closing.
- **Printer** – You will have to use a printing company that specializes in printing a prospectus document. Keep in mind that the printer must be able to take a revised draft of your registration statement and turn it around into a final registration document in a matter of days. Additionally, these documents must be tightly guarded from any preliminary leaking of information to the public.

> **Key Point ►** Seek SEC Opinions on Complex Financial Transactions
>
> If you have complicated financial transactions that might raise investor apprehension, consider asking for an opinion from the Securities and Exchange Commission (SEC). The SEC is the final word on financial disclosure issues and having them issue an opinion is a strong way to support and substantiate your positions on complex accounting issues.

Examples of Critical Duties for Certain IPO Team Members

Investment Public Relations	***Legal Council***	***Underwriter***	***Independent Auditor***
Arrange meetings with potential underwriters	Review and cleanup various corporate documents	Determine if the company can actually go public.	Assess the system of internal controls
Prepare press releases related to the IPO	Approve documents released concerning the IPO	Conduct due diligence to uncover misrepresentations	Compile financial schedules for public disclosure
Prepare certain summary sections of the Prospectus	Create an initial draft of the Registration Statement	Build a syndicate of investors to sell the public offering	Ensure company is a going concern and not at risk
Coordinate road show with potential investors	Respond to comments from regulatory agencies	Price the offering in relation to other public companies	Issue an audit opinion on financial statements

An "all-hands" meeting kicks off the IPO Team, assigning responsibilities, establishing deadlines, and setting the ground rules for how everything will work. Regular meetings will be held to trouble shoot and brainstorm various issues. It also helps to use checklists to ensure that all IPO team members are getting things done.

IPO Costs

There are several costs associated with going public. These costs include:

- Underwriting Fees – Underwriting is the highest cost associated with going public. Underwriters (investment bankers) collect a percentage of the total amount raised in the public offering (usually around 7%). The more complex the offering, the higher the underwriting costs. Also, the more shares sold, the lower the commission paid to the underwriter.
- Legal Fees – Attorney's will review and prepare various documents for regulatory compliance as well as perform due diligence.
- Audit and Accounting Fees – Most IPOs require a set of audited financial statements (not just the current year, but prior years as well).
- Listing and Registration Fees – There are registration fees involved with the Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), and the various states. For example, you have to register securities under the Blue Sky Laws in each state in which the company plans to do business or sell its securities. The fees associated with the Blue Sky Laws can run as low as \$10,000 or less up to \$50,000 or more depending on the number of states involved. And don't forget about franchise taxes, transfer taxes, and capital stock taxes.
- Printing – Printing can be costly, especially if there is an error with the prospectus. Printing can encompass not only the prospectus, but also underwriting documents and other legal documents.
- Public Relations – Long distance trips, presentations, lost time away from the office, and other costs will be incurred as you build investor interest for the public offering.

Don’t forget – a lot of these costs don't go away after the IPO. Every year you will incur audit fees, legal fees, quarterly reports, proxy reports, miscellaneous filings, annual reports, transfer agent fees, public relations, investor relations, and other expenses to keep the company public.

A typical breakdown of IPO expenses is summarized below:

Offering Value	**$ 25 Million**	**$ 50 Million**
Total Shares Outstanding	5,880,000 shares	5,880,000 shares
	Estimated Fee	*Estimated Fee*
Underwriting	1,750,000	3,500,000
SEC Fees	9,914	19,828
NASD Fees	3,375	6,250
Printing and Engraving	100,000	100,000
Accounting Fees	160,000	160,000
Legal Fees	200,000	200,000
Blue Sky Fees	25,000	25,000
Miscellaneous	34,200	34,200
Nasdaq Entry Fees	63,725	63,725
Nasdaq Annual Fees	11,960	11,960
Transfer Agent & Registrar	5,000	5,000
Total	**2,363,174**	**4,125,963**

Source: Going Public - Benefits and Responsibilities, NASDQ

Due Diligence

A major focus for any IPO Team will be due diligence. You need to uncover various flaws before you go public. Once the company is public, major discrepancies can result in lost creditability. In the public marketplace, once you lose your creditability, it is very difficult to get it back. Here is a brief list of certain due diligence steps:

Preliminary:

1. Assign adequate staff and resources to execute the IPO Process.
2. Make sure senior management and board members are the type that will function well before investment bankers, analyst, and others in the public world.
3. Make sure senior management and board members are free from conflicts of interests, including past criminal offenses.

Industry Comparisons:

1. Collect and analyze registration statements, annual reports, and various SEC filings from other similar public companies. This can serve as a baseline for public disclosure for your company.
2. Research trade publications, analyst reports, and other industry news to fully understand critical issues confronting your industry.

3. Isolate accounting and financial disclosure practices related to your industry, noting what is generally accepted for your industry.
4. Compile industry trend data – growth rates, cyclical trends, recent developments, long-term outlooks, etc.

Officer & Director Disclosure:
1. Compensation, both direct and indirect compensation must be fully disclosed.
2. Related party transactions with the company.
3. Current and prior positions held, both inside and outside the company.
4. Shares of stock owned and voting arrangements.
5. Any knowledge of significant pending transactions, litigation, or other issues that could be construed as "failure to disclose."

Legal Documentation in Place:
1. Documents pertaining to various regulatory filings, such as proxy statements with the SEC or other disclosures with various regulatory agencies.
2. Corporate documents, such as articles of incorporation, bylaws, charters, etc.
3. Minutes of board meetings, notes from important management meetings, and other important gatherings over the last five years.
4. Complete listing of shareholders or owners of the company, including names, shares held, and special provisions.
5. Significant agreements, contracts, applications, licenses, trademarks, and other legal documents important to the business.

Business Related Documents:
1. Financial statements, annual reports, tax returns, and other important financial schedules for the last five years.
2. Documents with key customers, partners, vendors, distributors, bank loans, promissory notes, etc.
3. Strategic documents – Business plans, financial forecasts, competitive analysis, marketing plans, etc.
4. Asset ownership – Deeds, Titles, descriptions of all significant assets held, etc.
5. Personnel Policies – Employment practices, including employee complaints and lawsuits.
6. Audit & Legal Correspondence for the last five years; especially with senior management and board members.
7. Insurance policies, claims, and related documents.
8. Public documents about the company, such as news articles, analyst reports, trade journal stories, etc.

Internal Analysis:
1. Financial analysis and benchmarking against the competition, such as ratio analysis.
2. Non-Financial analysis such as customer growth, product innovation, retaining talented people, leadership within management, industry reputation, etc.
3. Market analysis regarding primary customers, demographic trends, distribution channels, impact of technology, etc.
4. Strategic analysis of strengths of the company, critical issues, key performance metrics, future risks and challenges, short-term and long-term goals for success, etc.

<u>Accounting Controls</u>:

1. Assessment of internal control systems, including adequate capabilities to meet regular public disclosures and present audited financial statements in accordance with regulatory and industry practices.
2. Accounting practices follow generally accepted principles, including recognition of revenues in a conservative manner, investigation of significant changes in account balances, adequate reserves to ensure company is a going concern, and other accounting issues that may come up.

And don't forget, the Underwriter (Investment Banker) will also pursue very aggressive due diligence to ensure that the company is really ready to go public. This can be very distracting to management, requiring interviews, explaining in detail how the business works, completing lengthy questionnaires, verifying information, and visiting company sites.

Failure to Meet Preliminary Requirements for an IPO

- 53% failed to properly value recent stock options
- 31% did not have a formal Board that met regularly
- 23% lacked a business plan
- 20% had inadequate accounting systems and controls
- 16% lacked a history of audited financial statements
- 12% failed to produce regular quarterly financial statements

- 1998 Survey by Coopers & Lybrand of Fastest Growing Companies that declared they were "very likely" to go public.

The Investor's Perspective

A common-sense way of looking at your IPO is to see it as your investor will see it. This can be important since there is a dramatic difference between those who facilitate the IPO Process (lawyers, underwriter, accountants, founders of startup company, public relations specialist, etc.) and those who invest in the company. As author Ruthan Quindlen points out in his book, <u>Confessions of a Venture Capitalist</u> – "*The old adage about the hen and the pig providing a breakfast (of ham and eggs) – the hen is involved, but the pig is committed – is the perfect analogy. The analyst/banker is involved, but the investor is committed. Emotionally, the risk is much greater, but so are the rewards.*"

Once you appreciate this fact within the IPO Process, then you realize how important it is that you present "value" to investors. Investors will size a company up fast – comparing it against other similar companies. So one good argument you must have for investors is competitive benchmarking. In a study of approximately 500 firms that went public between January 1, 1986 through August 31, 1996, Ernst & Young found that successful IPO's clearly demonstrated superior competitive performance in terms of both financial and non-financial metrics.

"What we learn from all of the data is that respondents who reported highly successful IPOs also ranked their firms substantially ahead of their competitors along non-financial and financial criteria, far out-performing those who ranked themselves as equal to or less competitive than their peers. Not only, then, must the successful firm be competitive, it must be far more competitive than its peers if it is to withstand the acceleration period launched by the IPO."

- Managing the Success of the IPO Transformation Process by Sarah C. Mavrinac and Amy Blitz, Ernst & Young, 1998

Investors will also size your company up in relation to numerical trends. They will forecast what they expect to see based on past performance. For example, suppose you have $1.10 of revenue in relation to $ .70 of operating costs and $ .40 of non-operating costs per your most recent financial statement. Investors will look at prior financials and see $ .90 of revenue in relation to $ .60 of operating costs and $ .30 of non-operating costs, indicating a flat, breakeven trend. Investors will be looking forward financially. So be prepared to demonstrate strong positive trends to potential investors.

"When meeting portfolio managers and investors, for example, you have to be able to justify reasons for them to invest in your company. This is done by noting the current market conditions (which hopefully will be better than they are now), showing how and where your company's product or service fits into a particular industry in the market, and describing past, present and future anticipated successes."

- 10 Points on How to Go Public CFO Magazine, April 2001

Chapter 3

Registering the IPO

When a company goes public, it will have to issue new securities. In the United States, new security offerings are regulated under the Securities Act of 1933. Once a company is public, regular filings are regulated under the Securities Act of 1934. The Securities and Exchange Commission or SEC is responsible for administering the Securities Act of 1933 and 1934.

In order to sell securities, the sale must be registered with the SEC. Registration occurs on Form S-1, consisting of two parts:

Part 1: Prospectus – Primary disclosure to investors, disclosing the operations and financial condition of the company.

Part 2: Additional Information – Supplemental information furnished to the SEC (such as copies of important contracts).

The purpose of SEC Registration is to provide investors with sufficient information so they can make informed decisions about the investment. From an investor's viewpoint, disclosure of this information is captured in the prospectus. However, before we can distribute a prospectus to investors, we must go through a review process with the SEC, leading up to final registration.

The Registration Statement itself is regulated by:

Regulation S-K: Itemizes all non-financial information that must be disclosed. This includes description of the business, assets, types of securities, pricing, management discussion & analysis, compensation of key officers, risk factors, distribution plan, issuance cost, exhibits, and miscellaneous matters.

Regulation S-X: Itemizes all financial data, form, and periods to disclose. This includes 3 years (2 years for the Balance Sheet) of audited financial statements.

Regulation C: Describes the filing procedures for the Registration Statement, including how to file amendments and how to withdraw the registration.

> **Key Point ►** Liability difference between S-K and S-X
>
> Since you will include forward looking information (such as expected growth rates) based on what you believe will happen, much of what is disclosed under Regulation S-K is protected under safe harbor provisions. However, information provided under Regulation S-X is not protected under safe harbor and thus, you may be exposed to more liability for providing misleading or false information under Regulation S-X than under Regulation S-K.

Since the bulk of the Registration Statement consists of the Prospectus, we need to fully understand what it takes to create a great prospectus. Important components of the Prospectus include:

- Summary information about the business
- Risk factors such as operating losses
- Listing of how proceeds will be used
- Description of how offering price was determined
- Management Discussion & Analysis on future business plans, financial condition, etc.
- Description of Business – 5 Year History, Primary Products, Markets Served, etc.
- Distribution of Proceeds to Underwriters, indemnification of underwriters, listed stock exchanges where stock is traded, etc.
- Management profile and backgrounds, directors, officers, compensation, loans, stock options, etc.
- Complete set of audited financial statements

A good starting point in the preparation of a prospectus begins with a review of other prospectus documents from similar public companies. This can be important since your registration statement gets filed with an "industry specialist" within the SEC and submitting a "creative" document can result in serious comments from the SEC. Try to stick with standard industry formats, schedules, and present information as other companies have presented similar information. Keep in mind that your objective is to submit a preliminary prospectus that is as good as possible so as to minimize major changes in your original filing.

Since a lot of people will be involved in preparing the prospectus (lawyers, underwriters, etc.), it helps to have one single coordinator in charge of making changes to the registration documents; otherwise things can get confusing. Legal council usually prepares the first draft of the prospectus. Certain sections will require expertise from different IPO team members; such as a clear discussion of strategy from management and financial schedules from accounting. Investment Bankers will be very involved in the preparation of the prospectus since they have extensive experience with what works and what doesn't. Investment Bankers also have very valuable insights into risk factors related to your industry, capital structures, pricing, and other market related issues.

Since the prospectus is the selling document for reaching potential investors, it helps to understand how investor's will see your prospectus. Here are some examples:

Prospectus Summary — Many investors screen investments by first reading the Prospectus Summary. This section summarizes the company's business and history, providing a discussion of the new capitalization (public offering) as well as useful financial summaries for the past several years.
Use of Proceeds — Usually, standard type language appears here, indicating that the proceeds from the public offering will be used for general corporate purposes. However, investors may be more interested in how proceeds are earmarked for specific expansion of the business. How will capital be applied to grow the business?
Capitalization — This section provides a current and after-the-fact view of shareholders' equity and long-term debt portions on the company's balance sheet. Investors are interested in what the capital structure will look like after the company goes public.
Dilution — This section describes the impact of the new equity offering on current shareholders and their relative ownership once public.

Management's Discussion and Analysis (MD&A)— The MD&A section usually gets a lot of attention from both investors and the SEC. The MD&A is management's view of the company, giving investor's an inside perspective. MD&A must cover material issues impacting the financial condition of the company. Investors need to understand the reasons behind why the numbers are changing. According to the SEC, "It is the responsibility of management to identify and address those key variables and other qualitative and quantitative factors, which are peculiar to and necessary for an understanding and evaluation of the individual company."
Business — This section outlines a company's business plan. This is one of the "selling" parts of the prospectus since it describes the company strategy, explaining how opportunities will be met, how markets will be served with various product offerings, and how the business makes money. If investors are unable to understand how the business makes money, then you are raising doubts to potential investors.
Management — Investors must be sold on the qualifications of your management team. Investors will be asking questions, such as: Does management have the expertise to execute its business plan?
Certain Transactions — Third party transactions must be disclosed. Material self-serving type transactions will not be encouraging to investors.
Principal Shareholders/Description of Capital Stock — This section identifies who owns the company and if anyone will be selling stock in the offering. Investors do not want to see top executives selling their stock. In order to reassure investors, the Underwriter will impose a "lock-up" period of usually 180 days before management can sell its shares.
Legal Matters/Experts/Additional Information — These sections usually have standard type language. If any one of these sections is considerably long, then investors could question what is going on.
Financial Statements — A complete set of audited financial statements with applicable footnotes. The devil is in the details or footnotes; so investor's will be reading the notes, not just looking at the statements.

Once the IPO Team is satisfied with the Prospectus document, the next big decision is filing with the SEC. IPOs are about timing – you are trying to go public when the markets are ready. The Underwriter and Investment Bankers will advise on when to pull the trigger and file the registration statement with the SEC. In most cases, you will move very quickly and set in motion a mad rush to build investor interest before selling the stock.

The Registration Statement is considered filed when it arrives at the offices of the SEC, properly signed and paid for with a cashier's check or certified check. Form S-1 is filed with the main SEC office in Washington D.C. From a technical standpoint, the SEC is required to complete its review of the Registration Statement in 20 days; however this is not standard practice. Standard practice is to add a delaying amendment to your initial filing, allowing 30 days for review by the SEC.

The SEC will issue comment letters, sending into motion a mad rush by the IPO Team to turnaround answers and issue revisions to the initial filing. Legal Council will coordinate your response to the SEC. These comments will lead to a revised or preliminary prospectus, commonly referred to as a red herring; so named because of a practice of placing a red herring fish to throw dogs off the scent of the hunt. And now used to characterize how investors chase after a promising investment, only to find out it's a red herring.

"When the SEC staff issues its comment letter, a flurry of rewriting results in an amended registration statement, which is combined with updated financial statements and re-filed with the SEC as promptly as possible. Typically, this version of the prospectus is then printed in large numbers and distributed by the underwriters to the investment community. This distributed prospectus is typically referred to as the 'red herring.' Until 1996, the SEC required that the cover of a preliminary prospectus, which was being distributed, bear in red ink a legend, which advised that the prospectus was subject to change and that the SEC had not finally approved the offering. Under current practice, language to similar effect is required on the front cover and on occasion may be printed in red ink, but it not be."

- Going Public by Stephen M. Honig, The Portable MBA in Finance & Accounting

During the review period, the SEC requires that all communication be confined to what is contained within your prospectus. During this so-called "waiting" or quiet period, the stock issue is considered 'In Registration'. Under Rule 135, the SEC permits announcement of the public offering in a press release. However, the press release should not disclose the name of the underwriter, indicating that the offer will be made through a prospectus. The Prospectus is how investors should learn and understand your public offering.

"Companies can continue promoting their products and services during a quiet period, but as soon as they slip into the realm of promoting the company itself, trouble is likely to follow. 'It's OK if you're promoting the product," says Justin Bastian, a securities lawyer with Morrison & Foerster in Palo Alto, California. "But companies should be careful because it's a very thin line which separates that from promoting a company and its prospects.'

- Blinded by Silence by Todd Lappin, Business 2.0 Magazine, August 1999

If the SEC does not approve the registration, a 'Letter of Deficiency' is issued. The letter of deficiency will notify the company what was wrong. Thus, the effective date of your public offering must be postponed. Under Rule 155, you do have the opportunity to revert back to a private company within 30 days, provided that you have not sold any stock in the registration, you withdraw the registration, issue notification to private offerees, and disclose any post registration changes.

One common amendment to the registration will be a pricing amendment. This amendment is submitted when your filing becomes effective since a final offer price for the stock cannot be determined until the final days just before going public. The public offering price and the effective date are not contained in the preliminary prospectus (red herring). These two things are not known during the waiting period. Generally, the public offering price is determined on the effective date. That way, the issue can be priced in accordance with current market conditions.

Key Point ► On Going Disclosures to the SEC

Once public, the company will be required to file several forms on an as needed basis, such as:

10 Q Quarterly Report: Financial results, management discussion, and other disclosures are filed for the three quarterly periods leading up to the fourth quarter when the annual filing is made.

10-K Annual Report: Complete set of audited financials, management discussion, and numerous other disclosures for the annual fiscal year.

8-K Current Report: Material events must be reported to all investors at the same time per Regulation FD (Fair Disclosure).

144 Insider Trading: When officers and board members sell their stock, they must first register their intent to sell on Form 144.

13D Beneficial Ownership: When an individual or company acquires more than 5% ownership of another company, this must be disclosed.

DEF-14A Proxy Statement: Prior to the annual meeting, a company must disclose executive compensation and any changes in corporate governance.

If all goes well, the SEC will issue an order declaring the registration effective. The company can elect to receive a phone call from the SEC. Once approved, the company can print off a final prospectus. The Underwriter is responsible for making sure every investor has a final prospectus once the sale is made.

Regulation A Filings

Most companies will file Form S-1 for full registration with the SEC. However, there are some exceptions to Form S-1. For example, small public offerings (Regulation A) are exempt from formal registration provided that:

1. The company must be a U.S. or Canadian company.
2. The total offering cannot exceed $ 5 million over a 12-month period.
3. The offering cannot represent a re-sale of stock by an affiliated company if the issuing company has not had income for at least one of the last two prior fiscal years.
4. The issuing company cannot be an investment or public company.

One of the advantages to a Regulation A offering is that you can openly promote and advertise your stock offering, allowing you to “test” the marketplace without the major effort and expense of a formal S-1 type IPO. However, you still must file with the SEC on Form 1-A which includes a set of financial statements in accordance with GAAP (generally accepted accounting principles); but not audited.

Regulation D Filings

Another exemption to formal filings is through Regulation D. This is a direct type offering by the issuing company, covering either equity (sale of stock) or debt (such as a promissory note). Regulation D offerings are sometimes used to finance the production of movies, expansion of retail stores, or generate some seed capital for a product development project. A quick summary of certain Regulation D exemptions is as follows:

Rule 504: Any organization not subject to continuous reporting and not an investment company where the total amount of the offering does not exceed $ 500,000 during a 12-month period prior to the offering.

Rule 505: Any organization except an investment company where the total amount of the offering does not exceed $ 5 million and the total number of non-accredited investors does not exceed 35.

Rule 506: Any organization where the total number of non-accredited investors does not exceed 35 and general solicitation of the offering to general investors is restricted.

Direct offerings (Regulation D) are best used for companies that have strong market recognition with a group of potential investors and the company seeks a modest amount of capital, sometimes as low as $ 50,000.00.

Dutch Auctions

One of the dilemmas within the IPO process is that many smaller companies and smaller investors are excluded from participating. IPOs are more or less controlled through big investment bankers and institutional investors. Some have advocated a more open approach to how IPOs are offered and priced. One such advocate is Bill Hambrecht, founder of WR Hambrecht & Company, a firm that provides open IPOs to investors.

Hambrecht has advocated a descending price (Dutch) auction over the internet whereby investors bid to acquire stock. The company that offers the stock will evaluate bids and establish a price that works for both the company and those investors who are willing to pay the established price set by the company. Everyone who meets the minimum bid price gets a proportional share of stock. There are no discounted prices offered to the big institutions; everyone is treated the same way. One of the advantages to this fast and instant approach to an IPO is the fact that many public offerings lose their investor appeal in a matter of days. Internet based dutch auctions counter this problem by making the offering accessible to all investors in a very short period of time.

> "Frankly, the fact that underwriters have favored good customers is about as shocking as discovering that professional wrestling is scripted. One could even argue that institutional investors deserve shares in hot IPOs in exchange for buying shares in tepid ones. But it is illegal for underwriters to collude with investors to ensure that a stock that goes public goes up in its debut and then keeps rising. "
>
> - Fixing the IPO Game by Loren Fox, Business 2.0 Magazine, May 2001

Chapter

4

Selling the IPO

One of the key players in making the IPO happen is the Underwriter. The Underwriter will perform several important functions:

- Form a group of underwriters and brokers to sell the stock (syndicate)
- Raise the capital and turn the proceeds over to the company
- Prepare critical parts of the SEC Registration Statement
- Determine the amount of capital that can be raised in the public offering.

Underwriters (Investment Bankers) will ultimately advise the company if an IPO is possible. The Underwriter will carefully scrutinize the company, looking at the management team, past growth, market conditions, and other factors critical to the IPO. Some of the questions an underwriter will ask include:

1. What makes your company so unique in the marketplace?
2. Who are your customers?
3. Who competes with your company?
4. What are your competitive advantages?
5. What is the background of management?
6. What is the company's marketing plans?
7. What are the trends for revenues and earnings?
8. What are the company's products and / or services?

If any of these factors are too negative, then the Underwriter may advise against an IPO. So be prepared in advance to address the fundamentals of your business. Some of the better-known underwriters include Bear Stearns, Lehman Brothers, Merrill Lynch, Morgan Stanley Dean Witter, and Donaldson Lufkin & Jenrette. Using a high profile underwriter can help sell the IPO to potential investors.

> "Firms that go the IPO route typically do so through an investment bank. Here again, there's a definite pecking order. Prestigious banks like Morgan Goldman Sachs compete to bring public the most promising companies. The more impressive the roster of investment bankers, the more positive buzz the IPO will generate. Like a good auditor, quality investment banks perform their own due diligence before taking a company public and providing it with a de facto seal of approval."
>
> - Why Companies Fail by Mark Ingebretsen

Prior to meeting with the Underwriter, management should have an understanding of the following:

- Amount of capital that needs to be raised through the IPO
- The approximate price of the offering by looking at comparable companies
- Identification of potential investors
- Analysis of alternative financing plans to the IPO

> "An investment banker's ability to sell a company's stock to a targeted group of investors can affect the initial success of the IPO, its subsequent market performance, and even long-range corporate control. An investment banker should be able to place a stock among a desired mix of both individual and institutional investors, target a particular region of the country if necessary, and even attract international ownership."
>
> - Going Public (White Paper) - NASDAQ

The Underwriting Structure

A group or "syndicate" of underwriters will participate in the IPO, each collecting a part of the underwriting fee. The Managing Underwriter forms the syndicate based on professional relationships and past performance. The final syndicate can be somewhat exclusive. And competition can be somewhat intense between investment banking firms when the IPO is hot. The size of the offering, the geographical distribution of the stock, and the mix of investors will determine the size of the syndicate. The general goal is to have wide distribution for spreading the risk.

All syndicate members agree to buy a percentage of the offering. Members are broken out into brackets based on their capitalization levels, ability to sell the offering, level of underwriting business they do, and past business deals. Bracketing imposes a structure on the syndicate, setting the percentage of compensation each underwriter can receive.

Example of Bracketing:

Lead Underwriter – Merrill Lynch	30% of offering
1st Bracket – Dean Witter	1% of offering
2nd Bracket – Oppenheimer	.7% of offering
3rd Bracket – Dain Bosworth	.5% of offering
4th Bracket – R. G. Dickinson	.2% of offering

The Managing Underwriter is the lead underwriter trying to sell the stock. Managing Underwriters will use "selling groups" to sell the stock. Selling groups consist of brokers and dealers who try to sell the stock on a best efforts basis. If the Selling Group is unable to sell the stock, the stock gets transferred back to the Managing Underwriter who assumes the risk.

Key Point ► Underwriters should not control the overall IPO Process

Underwriters and Investment Bankers may try to direct and manage the entire IPO process so as to protect their own interest. The IPO Team, directed by executive management and the CFO, should be in charge of the IPO process since they are paying for the IPO.

Pricing

The final IPO price for the stock offering is determined based on perceptions in the marketplace. A company with the right public structure, right underwriter, right business model, and other right stuff should have the right perception in the marketplace.

Underwriters establish an initial price range by looking at similar companies in the public marketplace. It’s not unlike how a realtor establishes a price for your house when you put it up for sale. The Realtor looks at other similar houses already up for sale to get a general price range. However, a lot of research and analysis goes into setting the final offer price. This includes industry analysis, examining trends, extensive investigation of the company’s past performance, review of policies and strategies.

> **Key Point ►** Management should track stock prices
>
> Management can do its own tracking of similar companies, monitoring stock prices to gauge attitudes and perceptions in the marketplace. This gives management a benchmark to compare against the Underwriters final offering price for the company’s stock. Underwriters typically price an offering ten to twenty percent below comparable companies to ensure the stock offering will sell.

The company, its advisors, and the underwriter, will determine the amount of money that can be raised. Don't expect to raise all the money you need at the time of your IPO. Many companies focus on the basics - raising enough money to put expansion plans in place or reducing debt.

Once everyone agrees on the amount of money that will be raised, the number of shares is determined in relation to the price per share and the amount of capital to be raised. Typical pricing ranges are anywhere from $10 to $20 per share. Generally, one million shares is the low end of the amount of shares to be issued. Rarely will an issue go for less than 500,000 shares. A high enough number of shares are needed for liquidity. One reason we need liquidity is for large institutional investors. Larger investors, such as mutual funds and pension funds, need good liquidity to purchase the stock. Otherwise, their purchases (10,000 shares and on up) will account for too much ownership in the company. Many of these institutional accounts are prohibited by policy from owning more than 5% of a company. If the company only has 500,000 shares issued, 25,000 shares is the most many institutional accounts can purchase.

Underwriting Agreements

Throughout most of the IPO process, you will operate under a Letter of Intent with the Investment Bankers. It's not until everyone is absolutely sure that the company will be going public that you can execute a formal underwriting agreement to take the company public.

There are two different types of underwriting agreements – Firm Commitment and Best Efforts. With a Firm Commitment the investment bank agrees to purchase the entire issue from the company and then re-offer them to the general public. With this type of an agreement, the investment bank has guaranteed to provide a certain amount of money to the company. The risk of the issue falls entirely upon the investment bank. If it fails to re-sell the amounts of securities it purchased, the investment bank still has to pay the agreed upon sum of money to the company.

The second type of agreement is known as a Best Efforts agreement. With a Best Efforts agreement, the investment bank agrees to sell the securities for the company, but does not guarantee the amount of capital raised by the issue.

Key Point ► Firm Commitment or Don't Go Public

If you cannot secure a firm commitment from investment bankers, you should not go public. You must have a commitment from underwriters to ensure that the IPO is successful.

Road Show

As indicated earlier, the Prospectus is the primary tool for selling the IPO before potential investors. We also have to restrict our communications until such time as the Registration is final. So the dilemma is how do we reach potential investors with a preliminary prospectus (red herring), but at the same time remain quiet about promoting the company. The answer resides in something called the Road Show.

The Road Show is a series of face-to-face presentations to potential investors. Since the final registration is only weeks away from approval, the Road Show is very intense, compressed into a short few weeks before the company goes public.

> "A going-public road show is one part traveling circus, one part brothel. Seven or eight times a day, the executive team of the would-be public company visits high-powered bankers and investors to perform a highly choreographed routine. The preparatory work is enormous – SEC filings, multimedia presentations, logistics – but in the end it's all about the meetings. A road-show team wants every target investor to feel they are the single most important potential investor the team has ever met. And they want to be able to get through the pleasuring and the pillow talk in less than an hour so they can get up to do it all over again with the next most important investor."
>
> - dot.bomb: My Days and Nights at an Internet Goliath by J. David Kuo

The Road Show must create a positive image of the company before large investors. The management team needs to be well prepared, well spoken, more knowledgeable than anyone else in the room about the industry and the competition. And remember to stick to what's contained within your prospectus. Discussing revenue and earnings forecasts is outside the scope of the Prospectus. Therefore, focus on things like historic earnings growth, revenue growth, R&D expenditures, percent gain in market share, growth in return on equity, growth in assets, and financial condition. And expect several detailed questions about your markets, competition, and aspects of the business plan.

Key Point ► Consistent Message

When giving a presentation to potential investors it is important to distribute the same information and go through the same identical presentation. You must deliver the same quantity and quality of information at all meetings to ensure that there is a level playing field for all potential investors.

Since you have only one chance to make the right impression, the Road Show must be flawless. Here are some important points to consider:

• Have a well-focused presentation for investors based on the key selling points outlined in the prospectus. It should include the company's major strengths, strategies, earnings expectations, market potential, peers and competitors, and management expertise.
• Make sure everyone is well prepared with presentation training / refresher sessions, media interview techniques, Q & A briefing manuals, and dry-runs.
• The use of an investor hand-out package is not technically allowed; but many companies do it regardless. Just make sure you stick to a condensed version of your preliminary prospectus. Craft this document in close conjunction with the underwriter and legal counsel. And also make sure other materials, such as press releases and media interviews follow the Prospectus.
• Organize road show logistics to cover several regions and in some cases, it may be appropriate to give the IPO some international coverage. Work with securities firms to ensure the widest possible investor audience. Target a list of "lead steer" sell-side and buy-side analysts, portfolio managers, and brokers.
• Monitor investor acceptance. This feedback allows management to fine-tune its messages during a road show.

"To do a successful IPO, you need a very strong story that can be communicated quickly to potential investors. When you are on the road shows, you must differentiate yourself and have a strong plan you can execute. The pitch also has to have a certain pizzazz. A company making auto supply products or HVAC equipment probably isn't sexy enough unless there is some unique angle. You need a strong story of growth and a lot of differentiation in the marketplace. Management also gets extra points for having strong communication skills. A CEO with some punch can drive the story home."

- Buyout: The Insider's Guide to Buying Your Own Company by Rick Rickersten with Robert E. Gunther

During the Road Show, the Underwriter will get non-binding commitments from potential investors, indicating the number of shares the investor is willing to buy. Underwriters will also approach large institutional investors, trying to build interest. As interest is generated, the Managing Underwriter starts to "build the book" of orders, determining the amount of stock that should be distributed to the Selling Group. The final distribution of stock to the Selling Group is subject to change, depending upon the shares actually offered and the demand for the stock from syndicate members and large institutional investors. If the IPO is hot, then the Selling Group may end up with less than 50% of the stock it requested.

Closing

The actual sale of stock cannot take place until the SEC has approved the registration statement. Once approved, a final prospectus is released to investors. During this time, the Underwriter will closely monitor market conditions since timing is everything. If the Underwriter believes the market is acceptable, then the company goes public.

> "Do you want to know what an IPO feels like? Honestly? You feel like you're about to die. You're standing at heaven's gate, your whole life is flashing before you, and there's a judgment coming. We'd never done this before. We weren't bankers. We didn't know what it all meant. In my head, I'd worked out all those grossly exaggerated animated scenes, but then I'm standing there actually mumbling stupid things like a Warner Brothers cartoon character.
>
> Then it hits. Three, two, one . . . . Boom. The main trader yells out, '87!'. He was frenetically writing down numbers on some papers, and the whole room – bankers and everybody – was yelling and screaming. The whole room was one giant 'Waaaaaa!' Everyone started howling; a few guys threw their phones down. All these heads popped up like prairie dogs; everyone was looking. It was total primal chaos."
>
> - A Very Public Offering: A Rebel's Story of Business Excess, Success and Reckoning by Stephan Paternot, Co-Founder of theglobe.com

Once the stock begins to trade, the Underwriter will provide "after market support" to maintain stability with pricing. The Underwriter also has an over-allotment of shares to work with. So if the stock price is well above the initial price, the Underwriter can purchase additional shares (up to 15% of the offering) within the first few weeks of the offering. This is referred to as a Green Shoe Option.

The closing for the IPO takes place three days after the effective date of the offering. This is when the proceeds from the IPO are paid to the company. Several documents are presented at the closing:

- The underwriter's letter to the transfer agent stating the shareholders' names and the stock denominations.
- Any certification by selling shareholders (if necessary).
- The verified certificates of incorporation and the good standing of the corporation and its subsidiaries (if any).
- The Company will provide a stock disposition letter to the transfer agent.

- A letter by the Company asserting that it has complied with all legal requirements. The letter will also state that it has received approval of all actions leading to the closing and most importantly, that no publicity or events occurred that had a material affect on the initial public offering.
- The underwriter's legal counsel will provide a final opinion letter to the underwriter.
- The Company's legal counsel will provide a final opinion letter to the underwriter.
- Company counsel will provide a stock issue validity letter to the transfer agent.
- Exchange of receipts list.

The IPO closing is the biggest event in the company's history. It is a euphoric climax to a well-planned and deliberate process. And now management will be watching every day as their ticker symbol moves across the board, displaying the price of the stock. Going forward, everything is open to the public and every quarter, shareholders will ask the same question: *How well did we do?*

> "People often ask me if I regretted actually going public or if there could have been another way to do it. The answer, of course, is yes and no. With hindsight, I would have much preferred staying private because life then doesn't become determined by a stock price or the valuation of the company. Anyone who wants to get into it does so because of a belief in the business, not necessarily to make a quick buck.
>
> I'm glad for the experience, and I'm glad because back then it was a necessity, a rite of passage. After all, going public gives you creditability and lets you grow your business faster; it attracts the advertisers and the investors. And you get cheap capital..
>
> In the final analysis, it was a necessity. It had to be done. From a personal stance, I sometimes wish I could take it back. But .. whatever. No matter what happens, all I know is that we had a great idea."
>
> - <u>A Very Public Offering: A Rebel's Story of Business Excess, Success and Reckoning</u> by Stephan Paternot, Co-Founder of theglobe.com

Course Summary

IPO's require rigorous planning, intense time management, a first rate team of professionals, an extremely creditable group of executives, and an outstanding business plan. Even if all of these elements are pulled together, the company still must consider alternative financing plans due to volatile market conditions.

The main reason for going public should be to grow the business through increased capitalization. In reality, many IPO's are driven by the need to make the company liquid so investors can get a return for their risky investment. In order to go public, strong consistent growth rates should be in place to support this major increase in capital. Companies with slow growth rates should consider alternatives to going public since failure to put this major infusion of capital to immediate use can drive down valuations.

One of the key players in making the IPO happen is the Underwriter. Underwriters decide if the company can go public. In order to protect itself, the Underwriter will launch due diligence to see if the company has what it takes to go public. Therefore, the company should be very pro-active by building great fundamentals as well as a public infrastructure (such as an independent board of directors and publication of audited financial statements).

In the United States an initial offering of stock is regulated by the Securities and Exchange Commission (SEC). The SEC requires adequate disclosure to investors in the form of a prospectus. Legal council and the Underwriter will coordinate preparation of the Prospectus.

Once public, the company must meet continuous reporting requirements, not to mention investor scrutiny. So it's best to function as though you are public long before the IPO. This will make the whole process much easier.

Recommended Reading:

1. Take Your Company Public by Drew Field (ISBN 0-13-882242-5)
2. Going Public: How to Make Your Initial Stock Offering Successful by Martin Weiss (ISBN 0-8306-3012-0)
3. Initial Public Offerings: A Strategic Planner for Raising Capital by David P. Sutton and M. William Benedetto (ISBN 0-917253-77-9)
4. Going Public: Everything You Need to Know by James B. Arkebauer (ISBN 0-0000-000000)
5. Going Public by Frederick D. Lipman (ISBN 1-55958-425-4)

Recommended Web Sites:
1. www.seclaw.com
2. www.iporesources.org
3. www.law.uc.edu/CCL/33forms
4. www.edgar-online.com/ipoexpress
5. www.businessandlaw.com/securities.shtml
6. www.sec.gov/divisions/corpfin/forms/securities.shtml (SEC Forms)
7. www.lawcommerce.com/forms (Corporate forms and agreements)
8. www.secinfo.com (most recent SEC filings)

Final Exam

Select the best answer for each question. Exams are graded and administered by downloading and installing the exe file version of this course. The exe file is located over the internet at www.exinfm.com/training.

1. Why is it so important to make a company “liquid” through an IPO?

    a. Realignment of the Balance Sheet

    b. Generate a return for original investors

    c. Improve the company’s image

    d. Secure more control over how the business is managed

2. A public infrastructure is critically important to ensuring that the company can function as a public company. Which of the following can help build a public structure for a private held company?

    a. Higher customer retention rates

    b. Stable cash flows

    c. Low overhead costs

    d. Publishing audited financial statements

3. The most significant costs associated with an IPO is:

    a. Registration fees

    b. Underwriting fees

    c. Audit fees

    d. Printing the Prospectus

4. It is extremely important to have a great management team. This helps sell the IPO before potential investors. If the management team is weak, one good source for building the management would be:

    a. Wall Street Analyst

    b. Academic Researchers

    c. Retired Senior Executives

    d. MBA Graduates

5. Which part of the Prospectus provides the investor with an inside perspective from management's viewpoint?

    a. Management Discussion & Analysis

    b. Listing of Proceeds

    c. Risk Factors

    d. Market Information

6. Which of the following IPO Team Members is responsible for pricing the public offering?

    a. Audit Firm

    b. Underwriter

    c. Senior Management

    d. Securities & Exchange Commission

7. After filing the Registration Statement and addressing comments from the SEC, the company will launch an intense effort to reach potential investors in a series of face to face meetings, commonly referred to as the:

    a. Closing Event

    b. Road Show

    c. All Hands Meeting

    d. Post Registration Conference

8. It is not uncommon for the Lead Underwriter to carry an over-allotment of shares, allowing the Underwriter to purchase stock at the initial offering price after the company has gone public. This is referred to as a:

    a. Underwriting Cushion

    b. Trading Bonus

    c. After Market Support Fee

    d. Green Shoe Option

9. If for some reason the company decides to cancel the IPO and continue as a private company, then it must do so within ________ days of the final registration per Rule 155

   a. 60

   b. 45

   c. 30

   d. 90

10. A direct approach to a public offering is available under:

    a. Regulation S-K

    b. Regulation D

    c. Regulation S-1

    d. Regulation X-4