

2015 IPO Report

CORPORATE



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2 US Market Review and Outlook

REVIEW

Building on the momentum from 2013, and boosted by a strong performance from life sciences and venture capital-backed companies, the 2014 IPO market produced 244 IPOs. The year's total was the highest annual figure since 2000 and almost one-third higher than the annual average of 186 IPOs recorded between 2004 and 2007—the last period of sustained offering activity. The number of IPOs has seen a steady annual increase in all but one of the past six years, and the last seven quarters have each produced 50 or more IPOs—a level of consistently high activity not seen since 2000.

Gross proceeds for 2014 were \$74.4 billion, an 80% increase over the \$41.3 billion in gross proceeds in 2013 and more than double the \$30.8 billion average annual figure over the twelve-year period from 2001 to 2012. The 2014 figure is the third-highest yearly figure ever, trailing only the gross proceeds of \$94.8 billion in 1999 and \$108.1 billion in 2000.

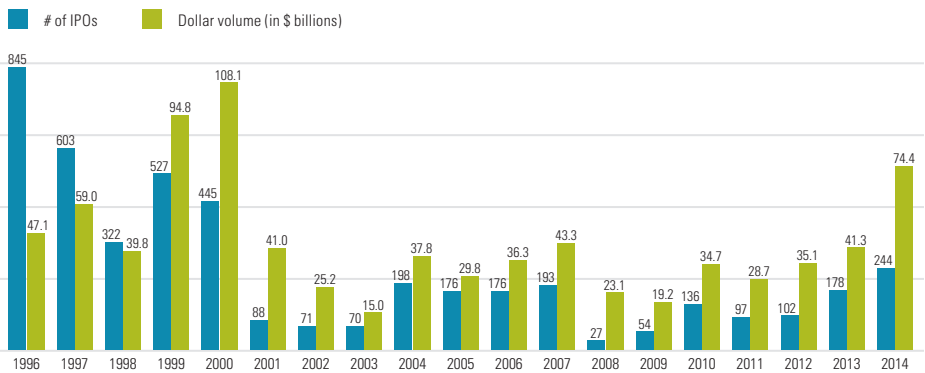
There were nine billion-dollar IPOs in 2014, more than double the average of four billion-dollar IPOs per year that prevailed for the preceding twelve years. The largest IPO of the year—also the largest in history—was Alibaba's \$21.77 billion offering. The next four largest offerings in 2014 came from financial institutions, led by Citizens Financial Group (\$3.01 billion) and Synchrony Financial (\$2.88 billion).

Emerging growth companies (EGCs) continued to dominate the IPO market in 2014. EGCs accounted for 85% of the year's IPOs, compared to 82% in 2013 and 76% in the portion of 2012 that followed enactment of the JOBS Act.

The median IPO offering size declined 11%, from \$107.4 million in 2013 to \$96.0 million in 2014, representing the lowest yearly figure since the \$89.3 million median offering size in 2004. Among EGCs, the median IPO offering size in 2014 was \$86.7 million—less than one-fifth of the \$446.7 million median offering size for all other IPO companies.

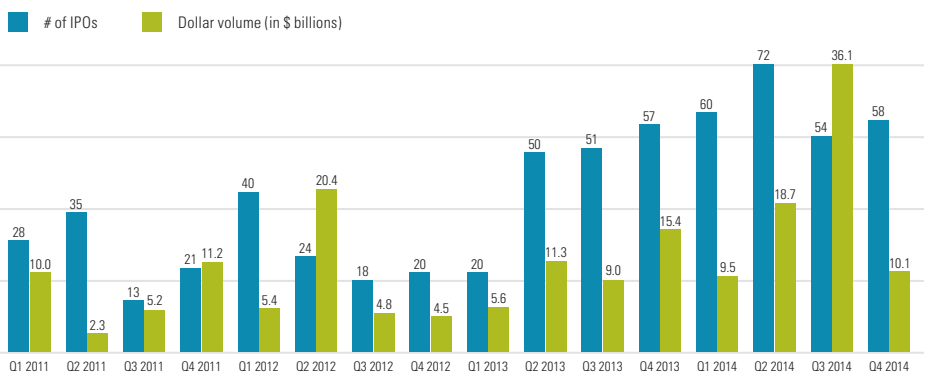
The median offering size for life sciences IPOs declined from \$68.6 million in 2013 to \$59.0 million in 2014. While the median offering size for non-life sciences IPO companies also declined, from \$187.0 million in 2013 to \$126.2 million in 2014,

US IPOs by Year – 1996 to 2014



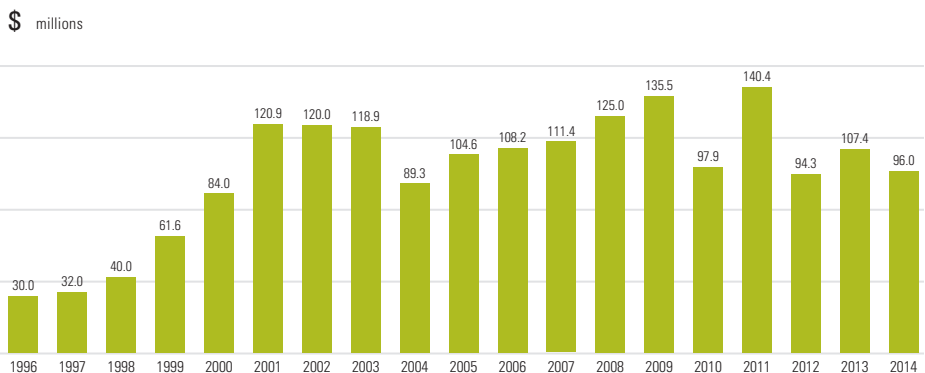
Source: SEC filings

US IPOs by Quarter – 2011 to 2014



Source: SEC filings

Median IPO Offering Size – 1996 to 2014



Source: SEC filings

the 2014 figure was largely in line with the \$124.3 million annual median deal size for non-life sciences IPO companies for the five-year period preceding 2013.

The average 2014 IPO gained 14% from its offering price on its first trading day—down from the 21% gain for all IPOs in 2013, but still the fourth-highest annual figure since 2000.

There were seven “moonshots” (IPOs that double in price on their opening day) in 2014—up from six moonshots in 2013. Only one of the seven moonshots, however, appreciated further over the remainder of the year. Ultragenyx Pharmaceutical eked out a 3% gain, while the other six saw an average decline of 40% from first-day close through year-end.

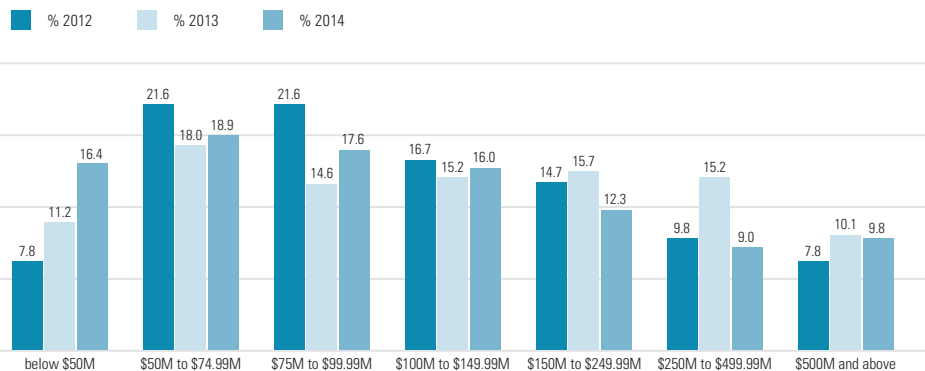
In 2014, 27% of all IPOs were “broken” (IPOs whose stock closes below the offering price on their first day), compared to 22% in 2013.

The average 2014 IPO company ended the year 24% above its offering price, topping the annual gains in the major market indices but falling well short of the 47% figure for all IPOs in 2013. Aftermarket gains were more modest, with the average 2014 IPO gaining only 9% from its first-day closing price through year-end. As of December 31, one-quarter of all 2014 IPOs were trading at least 50% above their offering price, while 38% were trading below their offering price, and 44% were trading below their first-day close.

The ten best-performing IPOs of 2014 came from six life sciences and four tech companies, all venture-backed. The year’s best performer was Radius Health, which was trading 386% above its offering price at year-end, followed by Auspex Pharmaceuticals (up 337%), Kite Pharma (up 239%) and TubeMogul (up 222%).

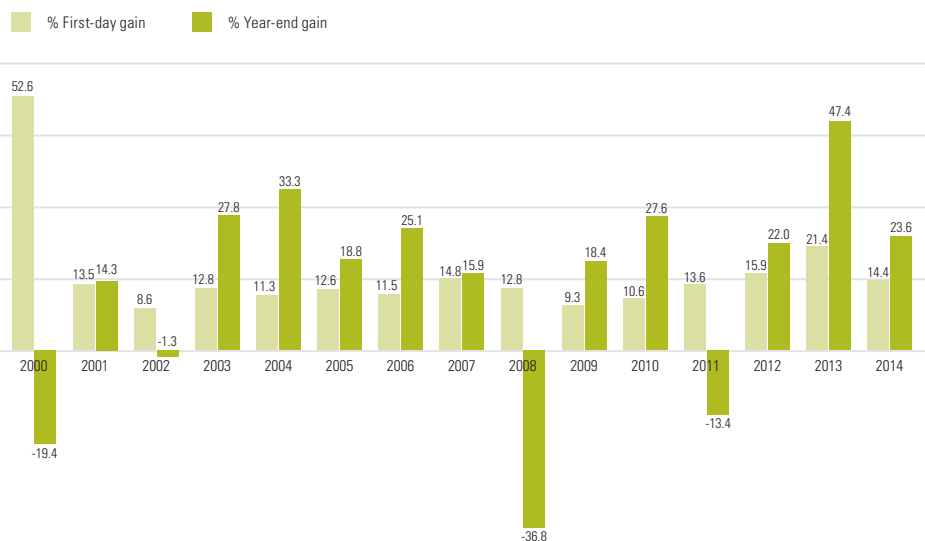
With life sciences company IPOs accounting for an increasing share of the overall IPO market—14% in 2012, 28% in 2013 and 40% in 2014—median annual revenue and profitability measures for IPO companies have plunged. The median annual revenue for IPO companies fell by one-third between 2012 and 2013, from \$133.6 million to \$89.9 million, and plummeted a further 24%, to \$68.2 million, in 2014—the lowest level since 2000. The percentage of profitable IPO companies declined from 55% in 2012 to 43% in 2013, and to 36% in 2014.

Distribution of IPO Offering Size – 2012 to 2014

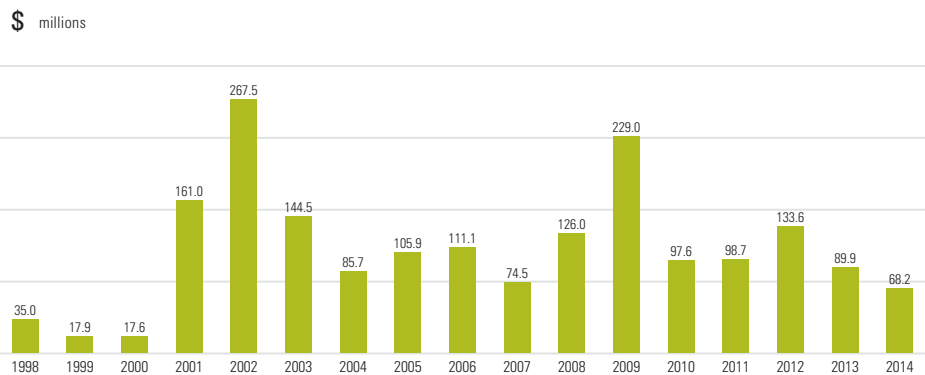


Source: SEC filings

Average IPO First-Day and Year-End Gain by Year – 2000 to 2014



Median Annual Revenue of IPO Companies – 1998 to 2014



Source: SEC filings and IPO Vital Signs

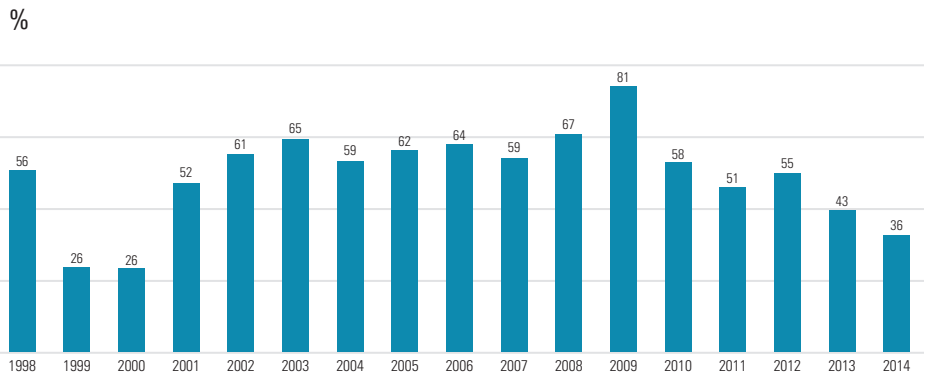
Among all life sciences IPO companies in 2014, median revenue was just \$1.2 million, and only 13% were profitable. Excluding life sciences companies, median annual revenue of EGC IPO companies declined by only 5% between 2012 and 2013, from \$120.6 million to \$114.5 million, and then fell a further 8%, to \$105.4 million, in 2014. The percentage of profitable non-life sciences EGC IPO companies slipped from 49% in 2013 to 46% in 2014.

The median annual revenue for non-EGC IPO companies declined by 9%, from \$2.54 billion in 2013 to \$2.32 billion in 2014. The percentage of profitable non-EGC IPO companies decreased from 75% in 2013 to 61% in 2014.

Individual components of the IPO market fared as follows in 2014:

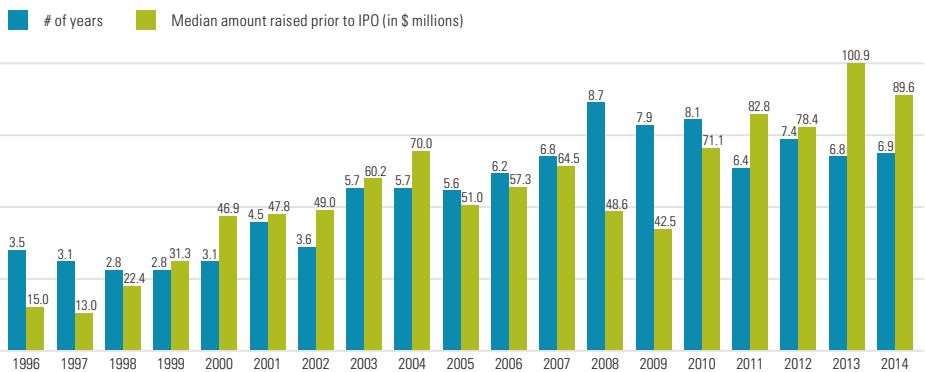
- VC-Backed IPOs:** The number of IPOs by venture capital-backed US issuers increased 42%, from 72 in 2013 to 102 in 2014. VC-backed IPOs accounted for 56% of all US issuer IPOs in 2014. The median offering size for US venture-backed IPOs declined 3%, from \$77.3 million in 2013 to \$75.0 million in 2014—the lowest yearly figure since the \$71.0 million median offering size in 2006. The median deal size for non-VC backed companies in 2014 was \$150.0 million. The average 2014 US issuer VC-backed IPO gained 32% from its offering price through year-end.
- PE-Backed IPOs:** Private equity-backed IPOs by US issuers declined 6%, from 48 in 2013 to 45 in 2014. PE-backed issuers accounted for one-quarter of all US-issuer IPOs in 2014, down from 34% in 2013. The median deal size for PE-backed IPOs in 2014 was \$231.5 million—almost triple the \$81.2 million deal size for all other IPOs. The average PE-backed IPO in 2014 gained 16% from its offering price through year-end.
- Life Sciences IPOs:** Life sciences companies captured 40% of the US IPO market in 2014, with 98 IPOs—almost double the 50 IPOs from this sector in 2013, a figure itself 16% higher than the annual average of 43 life sciences IPOs that prevailed in the three-year period between 2010 and 2012. The average 2014 life sciences IPO company ended the year 35% above its offering price,

Percentage of Profitable IPO Companies – 1998 to 2014



Source: SEC filings and IPO Vital Signs

Median Time to IPO and Median Amount Raised Prior to IPO – 1996 to 2014



Source: Dow Jones VentureSource and SEC filings

and 62% of the year's crop were trading above their offering price at year-end.

- Tech IPOs:** Deal flow in the technology sector remained strong in 2014. Tech-related companies (excluding life sciences companies) produced 69 IPOs, the largest number since 2000. However, the tech sector's share of the US IPO market fell to 28% in 2014, down from the average of 40% in the preceding five years, due to the large influx of life sciences company IPOs. Aftermarket performance of tech IPOs was about on par with the rest of the market in 2014, with an average gain through year-end of 24%, compared to the average gain of 23% for non-tech IPOs.
- Foreign Issuer IPOs:** The number of US IPOs by foreign issuers climbed from 36

in 2013 (20% of the market) to 60 in 2014 (25% of the market)—eclipsing the 56 in 2007, which had represented the high-water mark for foreign issuer IPOs since 2000. The number of US IPOs by Chinese issuers increased by 75%, from eight in 2013 to 14 in 2014. Israeli companies were the next most prevalent among foreign issuers, with 12 IPOs in 2014, more than double the five Israeli issuer IPOs in 2013, followed by UK issuers with six IPOs in 2014 compared to three in 2013. Aftermarket performance for foreign issuer IPOs in 2014 was, however, essentially flat. The average foreign issuer IPO company produced a gain of only 1% from its offering price through year-end.

In 2014, 94 companies based in the western United States (west of the Mississippi

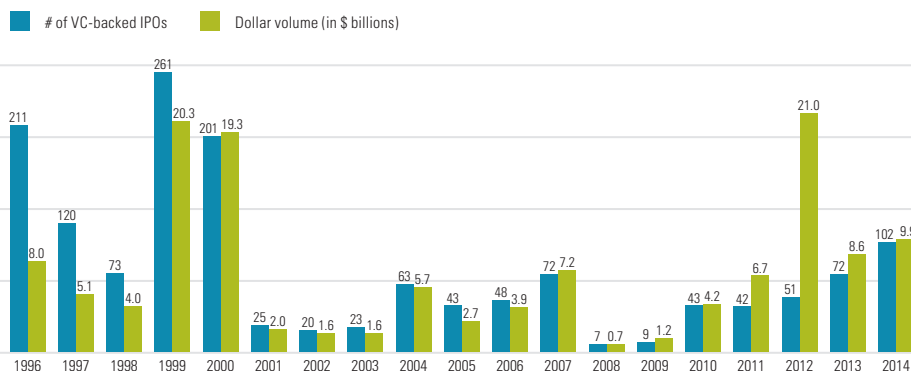
River) completed IPOs. Eastern US–based issuers accounted for 90 IPOs, and foreign issuers accounted for the remaining 60 IPOs. California led the state rankings with 54 IPOs, followed by Massachusetts (with 23 IPOs), Texas (with 20 IPOs) and New York (with 10 IPOs).

OUTLOOK

IPO market activity in the coming year will depend on a number of factors, including the following:

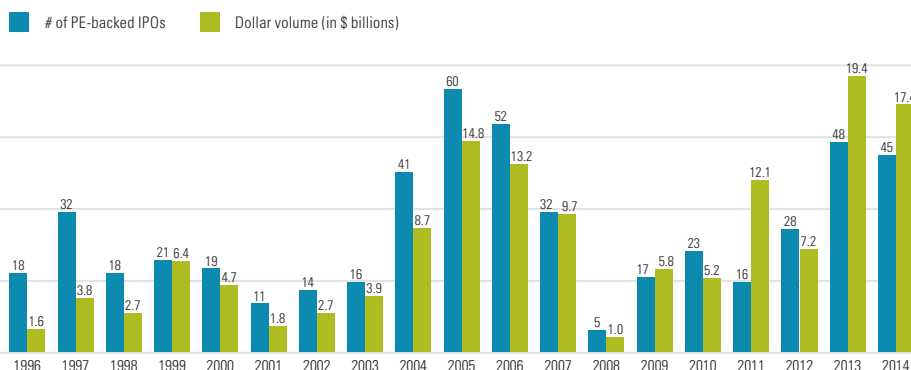
- **Economic Growth:** While the US economy has seen improvements in a number of key metrics, including job creation and an increase in household purchasing power due to declining energy prices, wage growth remains modest and the workforce participation rate—the labor force as a percentage of the whole population—is at its lowest level since 1978. Moreover, after more than six years with interest rates at historic lows, recent Fed statements raise the specter of a hike in interest rates later this year. Sustained economic growth will be key if the IPO market is to maintain or increase the pace that prevailed in 2014.
- **Capital Market Conditions:** Stable and robust capital markets remain a precursor to IPO activity. The major US indices posted impressive annual gains once again in 2014, with the Dow Jones Industrial Average, Nasdaq Composite Index and S&P 500 increasing 7.5%, 13.4% and 11.4%, respectively. On the heels of very strong gains in each of the past three years, similar gains may not be realistic in 2015, but a reduction in the market volatility that has periodically stalled IPO deal flow in recent years would help the market.
- **Venture Capital Pipeline:** Venture capitalists depend on IPOs—along with company sales—to provide liquidity to their investors. There has been a resurgence in VC-backed IPOs over the last five years, including IPOs by a number of high-profile companies, and the pool of attractive VC-backed IPO candidates remains large. Although venture capital investors often prefer a sale over an IPO because a sale usually can be completed faster and with greater certainty than an IPO, the outsized valuations that can be achieved in the

Venture Capital–Backed IPOs – 1996 to 2014



Source: Dow Jones VentureSource and SEC filings
Based on US IPOs by VC-backed US issuers.

Private Equity–Backed IPOs – 1996 to 2014



Source: Thomson Reuters and SEC filings
Based on US IPOs by PE-backed US issuers.

public market may be shifting the sale/IPO pendulum back toward IPO exits for the most valuable VC-backed companies.

- **Private Equity Impact:** Private equity investors seek to divest portfolio companies or achieve liquidity through IPOs. With private equity firms holding near-record levels of “dry powder” (unspent capital that investors have committed to provide), and general partners facing deadlines as the investment window starts to close on funds raised in 2007 and 2008, private equity sponsors can be expected to continue to pursue IPOs aggressively in 2015.
- **Impact of JOBS Act:** Enacted with great fanfare in April 2012, the JOBS Act is intended to improve access to the

public capital markets for EGCs. The vast majority of all IPO candidates can qualify as EGCs, but the extent to which the JOBS Act is responsible for the increase in the number of IPOs over the past two years is unclear. In any event, the confidential submission provisions of the act and the significant increase in the maximum number of stockholders that a private company may have without registering as a public company has given emerging companies more flexibility in timing their IPOs.

The IPO market has entered 2015 at a measured pace, with only 19 IPOs in January and February, compared to 37 in the first two months of 2014. If favorable market and economic tailwinds continue to prevail, however, a stream of new offerings should follow throughout the year. ■

6 Regional Market Review and Outlook

CALIFORNIA

The number of California IPOs grew for the fifth year in a row, increasing from 44 in 2013 to 54 in 2014. The 2014 count eclipsed the previous post-2000 high of 53 IPOs set in 2004.

Gross proceeds dipped from \$6.64 billion in 2013 to \$6.26 billion in 2014, largely as a result of the higher proportion of smaller IPOs by life sciences companies. The number of IPOs by California-based life sciences companies almost doubled, from 15 in 2013 to 29 in 2014—representing 38% of all US issuer life sciences company IPOs.

The largest California IPO in 2014 came from LendingClub (\$870 million), followed by GoPro (\$427 million) and Virgin America (\$307 million).

The California IPO market continues to be dominated by technology and life sciences companies, which together accounted for 89% of the state's offerings in 2014, compared to 68% of the overall US market. The number of venture-backed California IPOs increased by one-third, from 33 in 2013 to 44 in 2014—representing 43% of all US issuer VC-backed IPOs.

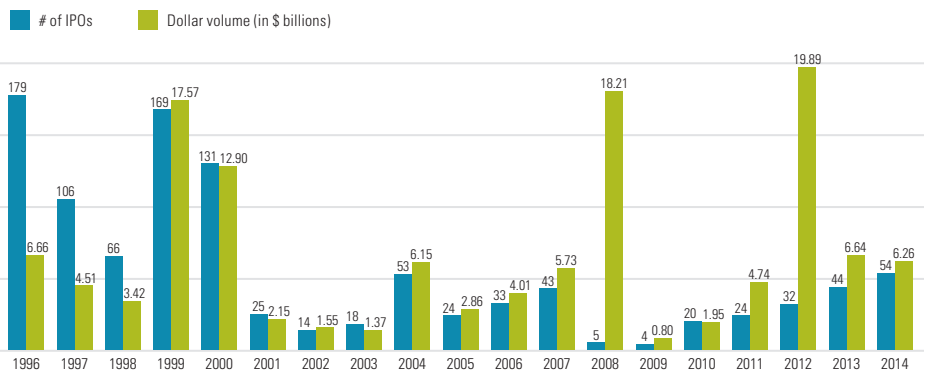
The average California IPO in 2014 produced a 30% first-day gain (triple the first-day gain for all other 2014 US IPOs) and ended the year 59% above its offering price (compared to an average of 14% for all other 2014 US IPOs). California's top performers in 2014 were Auspex Pharmaceuticals (up 337% at year-end) and Kite Pharma (up 239%). At year-end, 85% of the state's 2014 IPOs were trading above their offering price, compared to 55% of all other US IPOs in 2014.

With the largest pool of venture capital-backed companies in the country and a wealth of entrepreneurial talent, California should remain a major source of IPOs in 2015, particularly in the technology and life sciences sectors.

MID-ATLANTIC

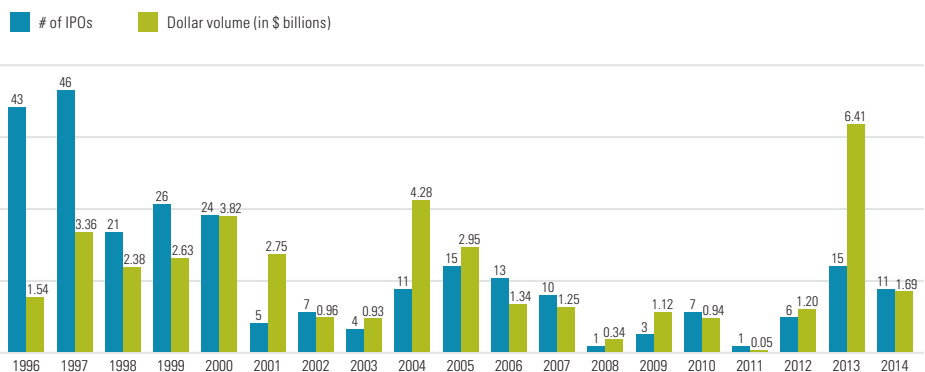
The number of IPOs in the mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia declined from 15 in 2013 to eleven in 2014. The 2014

California IPOs – 1996 to 2014



Source: SEC filings

Mid-Atlantic IPOs – 1996 to 2014



Source: SEC filings

tally was nonetheless the fourth-highest annual figure since 2000, behind only the 15 IPOs in both 2014 and 2005, and the 13 IPOs in 2006.

North Carolina led the region for the second year in a row, with five IPOs. Maryland and Virginia each contributed three IPOs.

Gross proceeds in the region plummeted from \$6.41 billion in 2013 to \$1.69 billion in 2014, but the 2013 tally was skewed by the region having produced three of the ten-largest IPOs of that year.

The three largest 2014 IPOs in the region came from Maryland-based TerraForm Power (\$502 million), North Carolina-based PRA Health Sciences (\$306

million) and Virginia-based Continental Building Products (\$165 million).

The average mid-Atlantic IPO in 2014 produced a first-day gain of only 8%, but gained a further 12% from its first-day close through year-end for a cumulative gain of 20% from its offering price. The region's best-performing IPO came from 2U, with a 51% gain at year-end, followed by K2M Group Holdings and INC Research Holdings, each with a 39% gain at year-end.

Technology- and defense-related companies historically have contributed a significant portion of the mid-Atlantic's IPO deal flow, but in the past two years the life sciences sector has come to the forefront. The mid-Atlantic region saw seven IPOs by life sciences

companies in 2014—64% of the region’s total. Life sciences company IPO deal flow should remain robust in 2014.

NEW ENGLAND

The number of IPOs in New England nearly tripled, increasing from 12 in 2013 to 32 in 2014, representing the highest annual tally for the region since the 41 IPOs in 2000. Massachusetts accounted for 23 of the region’s IPOs in 2014—the second-highest state total, behind only California—with Connecticut producing eight IPOs and Rhode Island adding one.

With the region home to the second-, third- and seventh-largest IPOs of the year, gross proceeds more than quintupled, from \$1.48 billion in 2013 to \$9.72 billion in 2014—the highest annual gross proceeds figure for the region in history. The largest New England IPO in 2014 was by Citizens Financial Group (\$3.01 billion), followed by Synchrony Financial (\$2.38 billion) and IMS Health Holdings (\$1.30 billion).

The number of venture-backed New England IPOs increased from nine in 2013 to 25 in 2014—representing one-quarter of all US issuer VC-backed IPOs in 2014.

Life sciences companies accounted for 63% of the region’s IPOs in 2014. Massachusetts produced 17 life sciences company IPOs in 2014—22% of all US issuer life sciences company IPOs—with Connecticut contributing three.

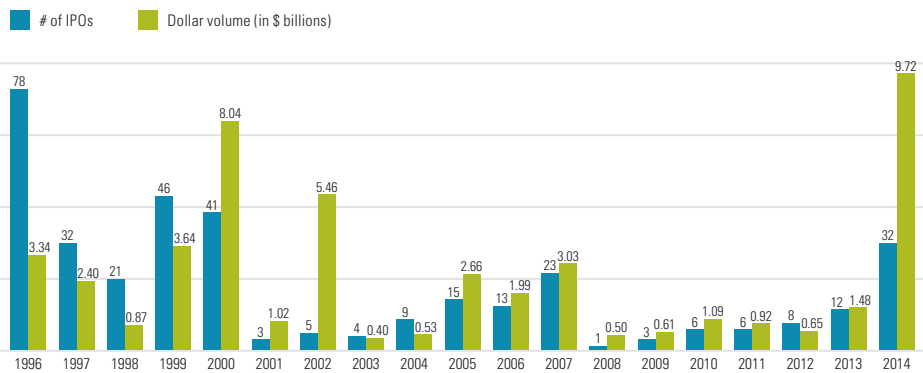
The average New England IPO in 2014 gained 18% in first-day trading, led by Dicerna Pharmaceuticals, which enjoyed a 207% first-day gain, making it only the second IPO since 2000 to have tripled on its first trading day. At year-end, the average New England IPO was trading 22% above its offering price.

With its strong levels of venture capital investment and world-renowned universities and research institutions, New England should continue to generate a vibrant crop of IPO candidates in the coming year.

TRI-STATE

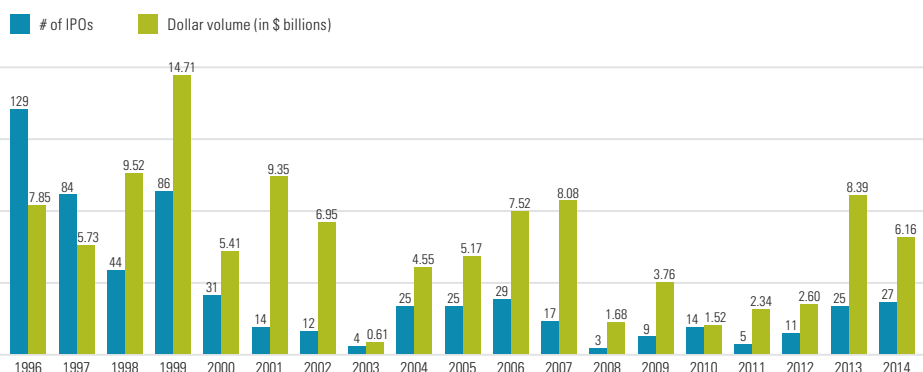
The number of IPOs in the tri-state region of New York, New Jersey and

New England IPOs – 1996 to 2014



Source: SEC filings

Tri-State IPOs – 1996 to 2014



Source: SEC filings

Pennsylvania increased from 25 in 2013 to 27 in 2014, the second-highest number of IPOs in the region since 2000, trailing only the 29 in 2006.

New York led the region for the second year in a row, with ten IPOs, followed by Pennsylvania with nine IPOs and New Jersey with eight. While the number of IPOs from New York declined slightly in 2013, the number of IPOs from New Jersey and Pennsylvania represented the highest annual number for those states in more than a decade.

Gross proceeds declined from \$8.39 billion in 2013 to \$6.16 billion in 2014. The three largest 2014 IPOs in the region came from Axalta Coating Systems (\$975 million), Rice Energy (\$924 million) and Catalent (\$871 million).

Technology and life sciences–related companies accounted for 70% of the region’s offerings in 2014, compared to an average of 48% over the preceding five years.

The region’s average IPO produced a first-day gain of 8%, but erased that gain to end the year 2% below its offering price.

With venture capital activity in the tri-state region now trailing only that of California, the number of VC-backed IPOs in the region continues to grow. In 2014, there were 12 venture-backed IPOs in the region, up by one-third from 2013 and the highest annual tally for the region since the 15 VC-backed IPOs in 2000. The region should remain a strong source of VC-backed IPOs in 2015. ■

8 Some Facts About the IPO Market

PROFILE OF SUCCESSFUL IPO CANDIDATES

What does it really take to go public?

There is no single profile of a successful IPO company, but in general the most attractive candidates have the following attributes:

- Outstanding Management:** An investment truism is that investors invest in people, and this is even more true for companies going public. Every company going public needs experienced and talented management with high integrity, a vision for the future, lots of energy to withstand the rigors of the IPO process, and a proven ability to execute.
- Market Differentiation:** IPO candidates need a superior technology, product or service in a large and growing market. Ideally, they are viewed as market leaders. Appropriate intellectual property protection is expected of technology companies, and in some sectors patents are *de rigueur*.
- Substantial Revenues:** With some exceptions, substantial revenues are expected—at least \$50 million to \$75 million annually—in order to provide a platform for attractive levels of profitability and market capitalization.
- Revenue Growth:** Consistent and strong revenue growth—25% or more annually—is usually needed, unless the company has other compelling features. The company should be able to anticipate continued and predictable expansion to avoid the market punishment that accompanies revenue and earnings surprises.
- Profitability:** Strong IPO candidates generally have track records of earnings and a demonstrated ability to enhance margins over time.
- Market Capitalization:** The company's potential market capitalization should be at least \$200 million to \$250 million, in order to facilitate development of a liquid trading market. If a large portion of the company will be owned by insiders following the IPO, a larger market cap may be needed to provide ample float.


How Do You Compare?

Set forth below are selected metrics about the IPO market, based on combined data for all US IPOs from 2007 through 2014, unless otherwise stated (EGC data for period following enactment of JOBS Act).

Percentage of IPO companies qualifying as "emerging growth companies" under JOBS Act	83%
Median offering size	\$106.7 million (13% below \$50 million and 9% above \$500 million)
Median annual revenue of IPO companies	\$93.8 million (34% below \$50 million and 19% above \$500 million)
Percentage of IPO companies that are profitable	51%
State of incorporation of IPO companies	Delaware—94% No other state over 1%
Percentage of IPOs including selling stockholders, and median percentage of offering represented by those shares	Percentage of IPOs—45% Median percentage of offering—30%
Percentage of IPOs including directed share programs, and median percentage of offering represented by those shares	Percentage of IPOs—40% Median percentage of offering—5%
Percentage of IPO companies disclosing adoption of ESPP	36%
Percentage of IPO companies using a "Big 4" accounting firm	81%
Stock exchange on which the company's common stock is listed	Nasdaq—59% NYSE—40% Other—1%
Median underwriting discount	7%
Median number of Form S-1 amendments (excluding exhibits-only amendments) before effectiveness	Five
Time elapsed from initial confidential submission to initial public filing of Form S-1 (EGCs only)	Median—60 calendar days 25th percentile—42 calendar days 75th percentile—86 calendar days
Overall time elapsed from initial filing (or confidential submission) to effectiveness of Form S-1	Median—116 calendar days 25th percentile—91 calendar days 75th percentile—175 calendar days
Median offering expenses (2014 IPOs)	Legal—\$1,463,500 Accounting—\$867,500 Total—\$3,001,000

Other factors can vary based on a company's industry and size. For example, many life sciences companies will have much smaller revenues and not be profitable. More mature companies are likely to have greater revenues and market caps, but slower growth rates. High-growth companies are likely to be smaller, and usually have a shorter history of profitability.

Beyond these objective measures, IPO candidates need to be ready for public ownership in a range of other areas, including accounting preparation; corporate governance; financial and disclosure controls and procedures; external communications; and a variety of corporate housekeeping tasks. ■

 The cornerstone of the JOBS Act is the creation of an “IPO on-ramp” that provides “emerging growth companies” (EGCs) with a phase-in period, which can last until the last day of the fiscal year following the fifth anniversary of an IPO, to come into full compliance with certain disclosure and accounting requirements. Although the overwhelming majority of all IPO candidates are likely to qualify as EGCs—more than 80% of all IPO companies since the enactment of the JOBS Act have been EGCs—the extent to which EGC standards are being adopted in IPOs varies. Moreover, practices differ between life sciences companies and other types of IPO companies.

CONFIDENTIAL SUBMISSION OF FORM S-1

An EGC is able to submit a draft Form S-1 registration statement to the SEC for confidential review instead of filing it publicly on the SEC’s EDGAR system. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements and signed audit reports. The SEC review process for a confidential submission is the same as for a public filing. A confidentially submitted Form S-1 must be filed publicly no later than 21 days before the road show commences.

Confidential submission enables an EGC to maintain its IPO plans in secrecy and delay disclosure of sensitive information to competitors and employees until much later in the process. Depending on the timing, confidential review also means that the EGC can withdraw the Form S-1 without any public disclosure at all if, for example, the SEC raises serious disclosure issues that the EGC does not want made public or market conditions make it apparent that an offering cannot proceed. Confidential submission will, however, delay any perceived benefits of public filing, such as the attraction of potential acquirers in a “dual-track” IPO process.

REDUCED FINANCIAL DISCLOSURE

In the Form S-1, EGCs are required to provide only two years of audited financial statements (instead of three years), plus unaudited interim financial statements,

and need not present selected financial data for any period prior to the earliest audited period (instead of five years). Similarly, an EGC is only required to include MD&A for the fiscal periods presented in the required financial statements.

Some investors prefer to continue to receive three full years of audited financial statements and five years of selected financial data, and an EGC may be disadvantaged if it provides less financial information than its non-EGC peers. These deviations from historical norms are more likely to be acceptable to investors in the case of EGCs for which older financial information is largely irrelevant, such as startups in the life sciences industry.

ACCOUNTING AND AUDITING RELIEF

EGCs may choose not to be subject to any accounting standards that are adopted or revised on or after April 5, 2012, until these standards are required to be applied to non-public companies. This election must be made on an “all or nothing” basis, and a decision not to adopt the extended transition is irrevocable. Although appealing, this decision could make it harder for a company to transition out of EGC status, both from a technical accounting perspective and due to the potential need to reset market expectations. Moreover, the benefits are difficult to assess, as it is hard to predict which accounting standards will be affected in the future, and an EGC’s election to take advantage of the extended transition period could make it more difficult for investors to compare its financial statements to those of its non-EGC peers.

In addition, EGCs are automatically exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company (a so-called auditor discussion and analysis) that the PCAOB might adopt. Any other new auditing standards will not apply to audits of EGCs unless the SEC determines that application of the new rules to audits of EGCs is necessary or appropriate in the public interest.

REDUCED EXECUTIVE COMPENSATION DISCLOSURE

An EGC need not provide Compensation Discussion and Analysis (CD&A); compensation information is required only for three named executive officers (including the CEO); and only three of the seven compensation tables otherwise required must be provided. Investors generally appear willing to accept reduced compensation disclosures in IPOs.

SECTION 404(B) EXEMPTION

EGCs are exempt from the requirement under Section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company’s internal control over financial reporting (ICFR), beginning with the company’s second Form 10-K. It seems likely that many EGCs will adopt this exemption, although the election need not be disclosed in advance in the Form S-1. ■

EGC Elections

Based on IPOs initiated after enactment of the JOBS Act and completed by EGCs through 2014, below are the rates of adoption with respect to several key items of EGC relief:

ITEM	LIFE SCIENCES COMPANIES	TECH COMPANIES	OTHER COMPANIES
Confidential submission of Form S-1	93%	94%	88%
Two years of audited financial statements	87%	28%	51%
Deferred application of new or revised accounting standards	13%	13%	10%
Omission of CD&A	100%	98%	94%

10 Keeping Your DSP Company-Friendly

OVERVIEW

In a directed share program (DSP)—sometimes called a “friends and family” program—an IPO company requests that the managing underwriters reserve a portion of the IPO for sale to persons designated by the company, such as customers, vendors or other persons having a business relationship with the company. Along with an employee stock purchase plan (ESPP, discussed on page 11) and a stock incentive plan, a DSP can also provide a means for employees to invest in the company.

DSPs reached their zenith in the Internet-company mania of the late 1990s, when many IPO stocks shot up in price and IPO allocations for retail investors were particularly scarce. The popularity of DSPs has since waned, but a DSP can still be used to reward friends of the company by providing an opportunity to purchase shares at the IPO price in advance of anticipated price appreciation, and to strengthen the company’s important business relationships by encouraging investments in the company. A properly structured DSP should have minimal impact on the offering.

POTENTIAL RISKS

A DSP does, however, pose several potential risks:

- A DSP can be a distraction to the company’s management at a time when it should be focused on other IPO issues. Even if the participation criteria are predetermined and rigid, management inevitably will field requests and complaints.
- If employees are eligible to participate, ill will and financial hardship can result if the stock price declines following the IPO. Legal requirements may force foreign employees to be excluded from the DSP, potentially alienating a portion of the company’s workforce. (As an alternative to employee participation in a DSP, the company could establish an ESPP that commences upon the IPO.)
- The company’s relationships with customers, vendors or other business

participants could be harmed, rather than enhanced, if the stock performs poorly following the IPO. For example, the media has reported widespread unhappiness and purchase defaults among customers of several large companies when their IPO shares, which had been marketed aggressively to customers, declined sharply in price.

- If the trading price immediately declines, participants could default on their purchase commitments. The underwriting agreement will require the company to indemnify the underwriters against any damages or liabilities resulting from DSP purchase defaults.
- If purchasers are not required to sign lockup agreements, resales of shares acquired under the DSP could create downward pricing pressure in the aftermarket, when nearly all other insider shares are locked up.
- A poorly executed DSP could result in securities law violations, delaying the IPO while the company makes a rescission offer to the program participants.

TIPS TO MINIMIZE THE RISKS

If a company wishes to include a DSP as part of its IPO, the following steps should help minimize the associated risks and keep the plan “friendly” for the company:

- The DSP should be administered by one of the managing underwriters, rather than by the company. The underwriter must be equipped to handle the logistics of a DSP, which can involve anywhere from dozens to hundreds of participants, and must be familiar with the legal rules governing the related communications.
- The size of the DSP should be reasonable. Although DSPs sometimes represent as much as 10% of an offering, a DSP’s typical size is 5%.
- By establishing and adhering to objective standards for participation in the DSP, the company can avoid or reduce the chaos that often results from allocating shares with unfettered discretion. In assessing eligibility, the company should focus on the constituencies that matter most to the company’s success.

Prevalence of DSPs in IPOs

YEAR	TECH	LIFE SCIENCES	OVERALL
2014	39.1%	15.4%	33.1%
2013	31.7%	37.2%	42.4%
2012	30.8%	21.4%	37.9%
2011	37.5%	30.8%	39.4%
2010	37.8%	28.6%	43.5%
2009	31.3%	50.0%	41.9%
2008	None	50.0%	40.0%
2007	32.8%	40.0%	42.6%
2007 - 2014	33.9%	27.3%	39.5%

Source: SEC filings

- If employees are allowed to participate in the DSP, the company should consider using an evenhanded and simple formula with a modest cap, such as “each employee may purchase up to 100 shares.” When employee demand is expected to exceed the program size, consideration should be given to excluding officers and directors. Unless the company is willing to incur the expense of complying with all local securities law requirements, foreign employees should be excluded.
- The company may provide participants in the DSP with only very limited procedural information—not including share allocations—prior to the availability of a preliminary prospectus containing a price range (which will not occur until the road show begins). Before distribution to participants, written (including email) materials for the DSP must be reviewed by counsel and the managing underwriter administering the DSP.
- Lockup agreements should be required from all participants, unless the managing underwriters believe the immediate aftermarket can absorb the shares. FINRA rules require that lockup agreements with directors and officers also cover shares purchased in a DSP. ■

OVERVIEW

An employee stock purchase plan (ESPP) permits employees of a public company to purchase shares of common stock at a discount from the market price, with favorable tax treatment. If structured correctly, an ESPP can be particularly beneficial in conjunction with an IPO.

Among other requirements, Section 423 of the Internal Revenue Code:

- requires that substantially all employees (excluding 5% stockholders) be allowed to participate in the ESPP;
- imposes an annual limit of \$25,000 per employee on the value of the stock purchased under the plan;
- requires the company’s stockholders to approve the ESPP; and
- sets the minimum purchase price at 85% of the lesser of the fair market value of the stock at the beginning of the offering period and the fair market value of the stock on the purchase date.

Accounting rules (ASC Topic 718) adopted in 2004 require companies to recognize compensation expense over the requisite service period for stock grants made under an ESPP, unless the discount is 5% or less and there is no “lookback” feature allowing the discount to be taken from the market price at the beginning of the offering period. Prior to the adoption of ASC Topic 718, companies going public routinely established ESPPs because investor resistance was low, compensation expense was not incurred, and ESPPs were viewed as a cost-free employee benefit—in effect conferring a guaranteed discount of at least 15%, and potentially much more if the stock appreciated between the first and last days of the offering period.

In the first few years following this accounting change, many IPO companies stopped adopting ESPPs, or adopted ESPPs without a lookback feature to avoid the compensation expense. More recently, the incidence of ESPPs among IPO companies has been climbing, with ESPPs generally including lookback features despite the resultant compensation charges. For example, in 2014, a majority of all IPO companies adopted ESPPs—all but four of

these ESPPs had a 15% discount (the other four had a 10% discount), and all but two had a lookback feature.

The pros and cons of an ESPP are summarized below:

PROS

- An ESPP can encourage broad-based employee ownership of company stock.
- Through the use of payroll deductions, purchases under an ESPP are convenient and avoid brokers’ commissions.
- Although not a perfect substitute for a directed share program (DSP), an ESPP may help reduce employee disappointment if the company decides not to make IPO shares available to employees in a DSP.
- Participants can acquire shares at a discount from the market price. With proper structuring, an ESPP can even be used as a means to permit employees to invest at a discount from the IPO price.
- If the ESPP complies with Section 423, participants receive favorable tax treatment for the shares purchased under the ESPP, including deferral of any tax on the discount until the shares are sold, and the possibility of long-term capital gains treatment for further appreciation if applicable holding periods are met.
- If other employers with whom the company regularly competes for employees offer ESPPs and the company does not, it may be at a competitive disadvantage in hiring.

CONS

- In practice, many employees immediately sell the shares received under an ESPP, defeating the goal of encouraging employee stock ownership in the company.
- Unless the ESPP is structured with a discount of 5% or less and there is no lookback feature, the company will incur stock-based compensation charges, which will reduce its GAAP income (this may be less of a factor for companies that report EBITDA measures from which stock-based compensation charges have been removed).

Prevalence of ESPPs in IPOs

YEAR	TECH	LIFE SCIENCES	OVERALL
2014	52.2%	69.2%	45.9%
2013	51.2%	62.8%	38.1%
2012	53.8%	35.7%	33.3%
2011	43.8%	61.5%	33.8%
2010	16.2%	50.0%	22.4%
2009	25.0%	50.0%	23.3%
2008	60.0%	50.0%	40.0%
2007	39.7%	50.0%	29.8%
2007 - 2014	42.3%	60.1%	34.9%





















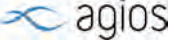















Source: SEC filings

- If the ESPP is structured to avoid the compensation charges, the attractiveness of the plan to employees is substantially reduced.
- Legal requirements may force foreign employees to be excluded from the ESPP, potentially alienating a portion of the company’s workforce.
- To the extent employees hold the stock acquired under the ESPP and the market price declines, ill will and disappointment among employees may result.
- The ESPP creates administrative obligations for the company, including annual IRS reporting requirements.
- Special arrangements will be required if the company desires to have the first offering period under the ESPP commence upon effectiveness of the Form S-1 at the IPO price. Pursuant to an SEC no-action letter, the company may enroll employees in the ESPP prior to the effectiveness of the Form S-8 (pursuant to which the shares will be registered) only if no money is collected before the Form S-8 is effective and if the initial deemed election for all participants is set at the highest permitted level. ■

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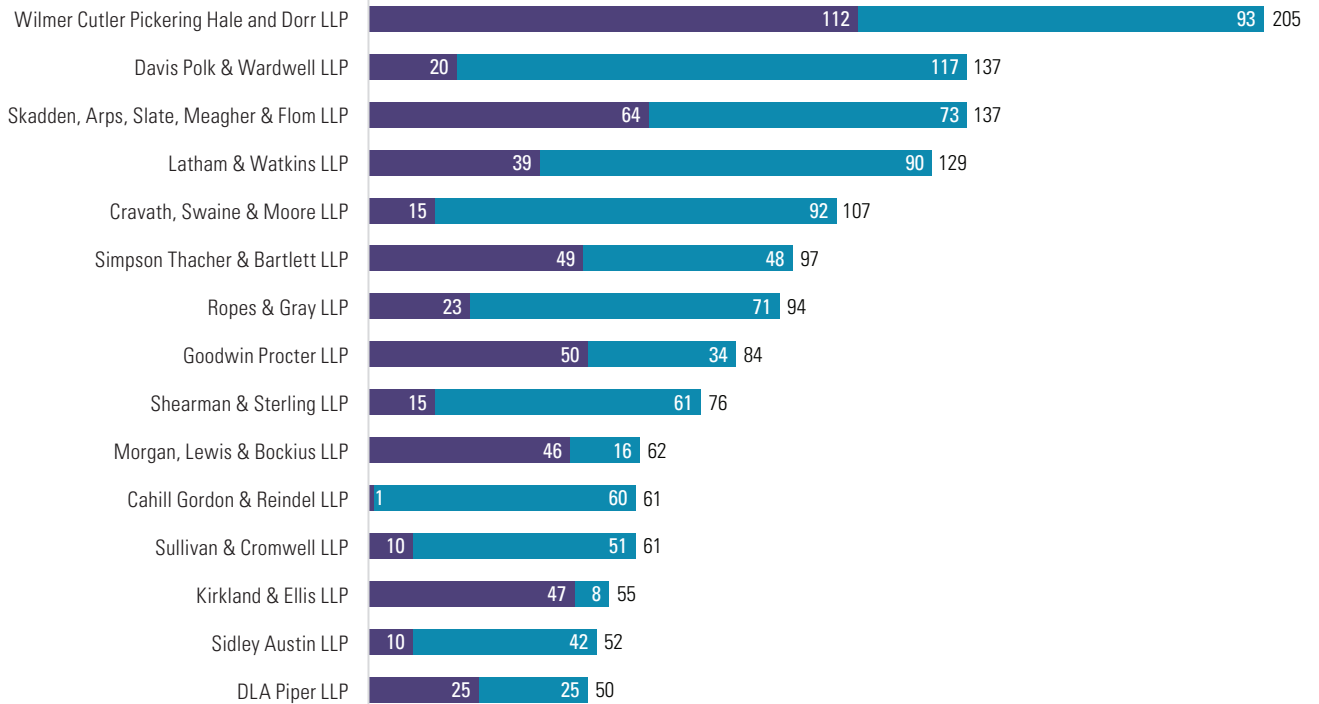


 Initial Public Offering of Common Stock \$60,000,000 Counsel to Issuer February 2015	 Initial Public Offering of Common Stock \$143,175,000 Counsel to Underwriters October 2014	 Public Offering of 3.150% and 5.100% Senior Notes \$600,000,000 Counsel to Issuer May 2014	 Rule 144A Placement of Convertible Senior Notes \$690,000,000 Counsel to Issuer February 2014	 Initial Public Offering of Common Stock \$59,500,000 Counsel to Issuer April 2014	 Public Offerings of 2.000% Senior Notes €640,000,000 and 3.300% Senior Notes \$800,000,000 Counsel to Issuer November 2014	 Initial Public Offering of Common Stock \$74,750,000 Counsel to Issuer July 2014	 Public Offering of Common Stock \$82,800,000 Counsel to Issuer February 2014	 Initial Public Offering of Common Stock \$185,150,000 Counsel to Issuer February 2015
 Public Offerings of Ordinary Shares \$1,199,725,000 Counsel to Underwriters May and September 2014	 Public Offerings of Common Stock \$191,450,000 Counsel to Issuer December 2014 and February 2015	 Public Offerings of Common Stock \$478,975,000 Counsel to Issuer November 2014 and March 2015	 Public Offerings of 1.50% Notes \$1,000,000,000 Counsel to Underwriters August 2014 and Floating Rate Notes \$1,000,000,000 Counsel to Underwriters January 2015	 Public Offering of Common Stock \$852,404,000 Counsel to Issuer May 2014	 Public Offerings of Common Stock \$522,400,000 Counsel to Issuer April 2014 and February 2015	 Initial Public Offering of Common Shares \$91,800,000 Counsel to Issuer February 2014	 Rule 144A Placement of 0.25% Convertible Senior Notes \$805,000,000 Counsel to Issuer October 2014	 Initial Public Offering of American Depositary Shares representing Ordinary Shares \$39,278,250 Counsel to Issuer March 2015
 Public Offering of Common Stock \$69,000,000 Counsel to Issuer March 2015	 Public Offering of 2.375% Senior Notes €300,000,000 Counsel to Issuer March 2014	 Public Offerings of Common Stock \$354,200,000 Counsel to Issuer April and December 2014	 Public Offering of Common Stock \$151,122,000 Counsel to Issuer February 2014	 Initial Public Offering of Common Stock \$57,500,000 Counsel to Issuer February 2014	 Public Offerings of Common Stock \$251,562,500 Counsel to Issuer February and October 2014	 Rule 144A Placement of 2.50% Convertible Senior Notes \$400,000,000 Counsel to Issuer January 2015	 Public Offerings of 3.300% Senior Notes \$1,000,000,000 Counsel to Issuer December 2014 and Non-Cumulative Perpetual Preferred Stock \$1,500,000,000 Counsel to Issuer March and November 2014	 Initial Public Offering of Common Stock \$86,250,000 Counsel to Underwriters June 2014
 Public Offering of Common Stock \$55,200,000 Counsel to Issuer September 2014	 Public Offering of Common Stock \$125,925,000 Counsel to Underwriters February 2014	 Initial Public Offering of Common Stock \$93,096,000 Counsel to Issuer February 2014	 Public Offerings of Preferred Stock \$150,000,000 Counsel to Issuer March and June 2014	 Public Offering of Common Stock \$145,526,000 Counsel to Issuer March 2014	 Initial Public Offering of Common Stock \$45,000,000 Counsel to Issuer February 2014	 Public Offerings of Common Stock \$228,384,000 Counsel to Issuer July 2014 and January 2015	 Public Offerings of Common Stock \$259,382,500 Counsel to Issuer October 2014 and March 2015	 Initial Public Offering of Common Stock \$105,300,000 Counsel to Issuer September 2014

14 Law Firm Rankings

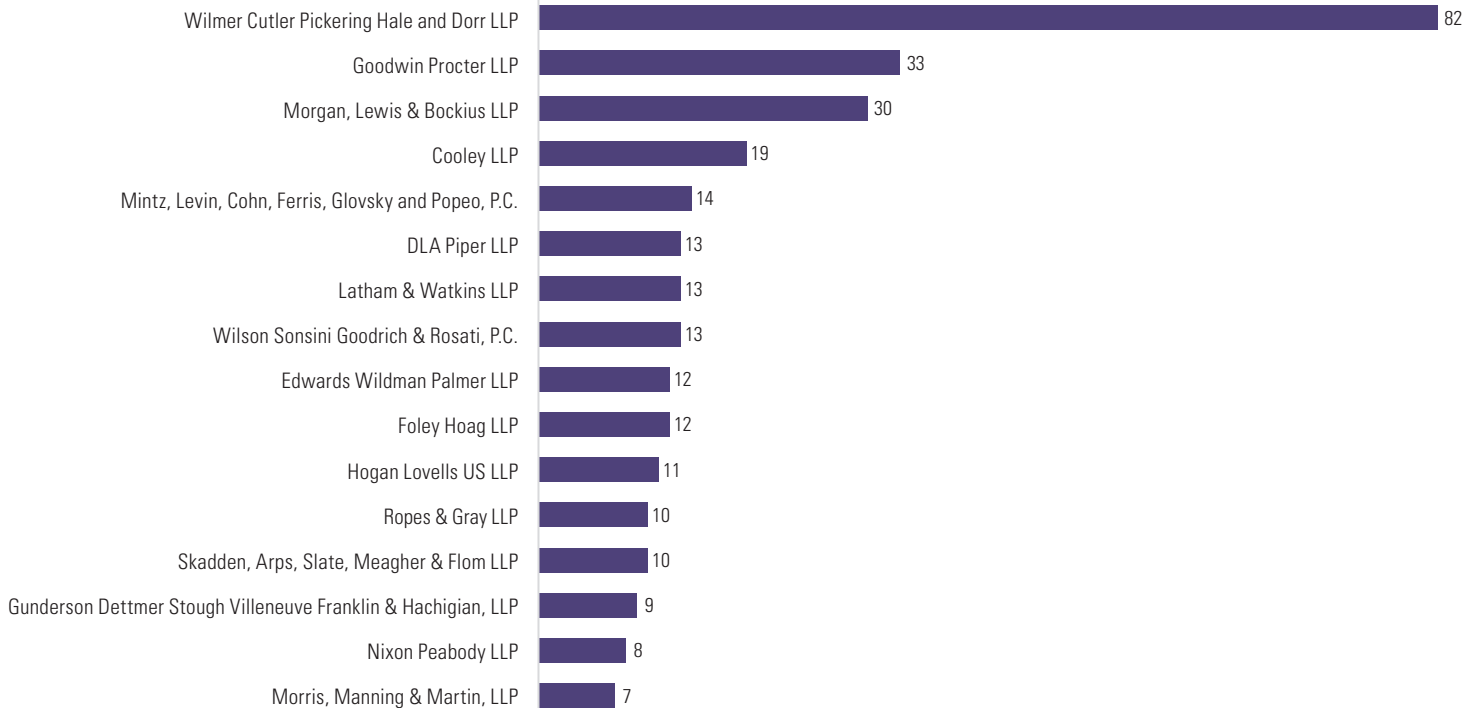
Eastern US IPOs – 1996 to 2014

■ Counsel to the Issuer ■ Counsel to the Underwriters



Source: SEC filings

Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2014

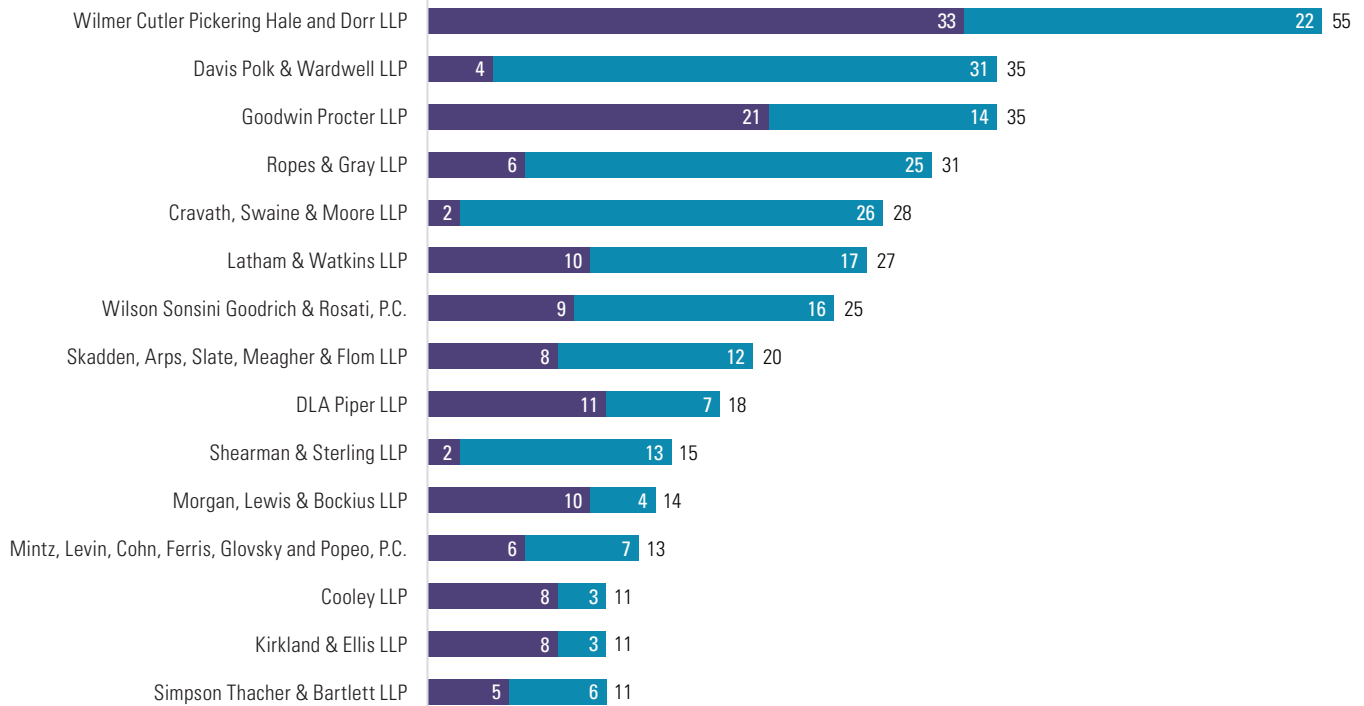


Source: Dow Jones VentureSource and SEC filings

The above charts are based on companies located east of the Mississippi River.

Eastern US Technology Company IPOs – 2000 to 2014

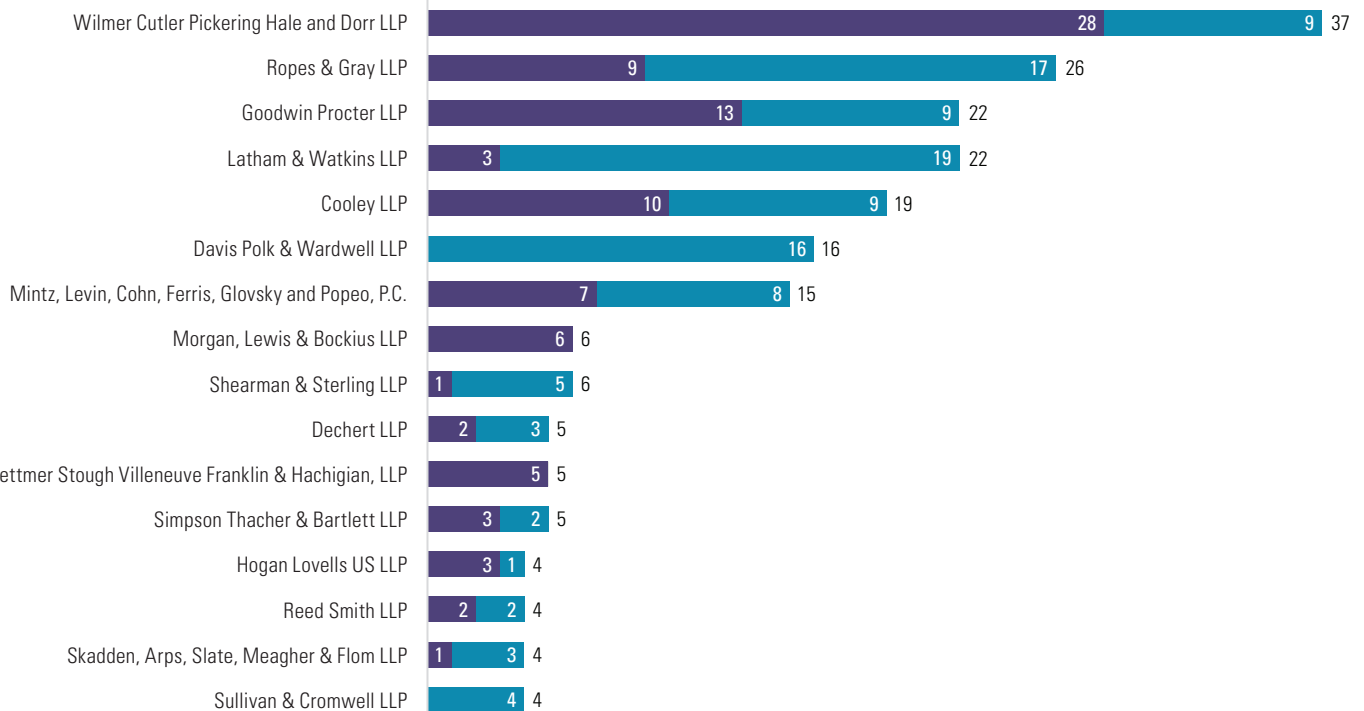
■ Counsel to the Issuer ■ Counsel to the Underwriters



Source: SEC filings

Eastern US Life Sciences Company IPOs – 2004 to 2014

■ Counsel to the Issuer ■ Counsel to the Underwriters



Source: SEC filings

The above charts are based on companies located east of the Mississippi River.

16 The Many Faces of Director Independence

IPO companies usually understand instinctively that a majority of the members of the board of directors should be independent. Less well understood or intuitive is what is meant by “independent” and when the independence requirements begin to apply. As discussed below, there are a variety of definitions of independence, depending on the context, and the requirement for a majority independent board and fully independent board committees does not apply immediately upon completion of an IPO.

GENERAL REQUIREMENTS

Nasdaq and NYSE rules require a majority of the members of a listed company’s board, and all members of the key board committees, to be independent within one year after the company’s IPO, under the phase-in rules described below. In order for a director to be considered independent, both Nasdaq and the NYSE require that:

- the director not have any relationship with the company that would be prohibited by that stock exchange’s “bright-line” independence standards; and
- the board, after taking into account all relevant information, affirmatively determines that the director is independent.

While there are some differences between each exchange’s bright-line independence standards, as a general matter a person cannot be considered independent if:

- he or she is, or at any time during the past three years was, an employee of the company;
- his or her family member is, or at any time during the past three years was, an executive officer of the company;
- he or she (or a family member) has, or at any time during the past three years had, a “compensation committee interlock,” which exists when an executive officer of Company A serves on the compensation committee of Company B at the same time that a director of Company A (or his or her family member) serves as an executive officer of Company B;

- he or she (or a family member) has, or at any time during the past three years had, certain specified relationships with the company’s auditor, including the company’s internal auditor in the case of the NYSE;
- he or she (or a family member) has certain specified relationships with another entity that, in the past three years, received payments from or made payments to the company for property or services with a value in excess of:
 - in the case of Nasdaq, the greater of \$200,000 and 5% of the recipient’s gross revenues for that year; or
 - in the case of the NYSE, the greater of \$1 million and 2% of the other company’s gross revenues for that year; or
- he or she (or a family member) received compensation from the company in excess of \$120,000 during any twelve-month period within the past three years, other than compensation for service on the board or a board committee, compensation paid to a family member as a non-executive employee, and certain other exempted payments.

Share ownership, regardless of how high the level, is generally not viewed by the stock exchanges as an impediment to independence for these purposes (but may preclude service on the audit committee, as discussed below).

PHASE-IN REQUIREMENTS

With some minor differences, the independence phase-in rules of Nasdaq and the NYSE provide that:

- The *board of directors* must be composed of a majority of independent directors within one year of the IPO.
- The *board committees*—including the audit committee, compensation committee and nominating committee—must each have at least one independent member at the time of the IPO, at least a majority of independent members within 90 days of the IPO, and must be fully independent within one year of the IPO.

Notwithstanding the permitted phase-in period for director independence and the composition of board committees, many public companies strive for immediate post-IPO compliance with all independence requirements for the board and board committees.

AUDIT COMMITTEE—“SUPER INDEPENDENCE”

Nasdaq and NYSE rules require that each member of the audit committee be:

- independent within the meaning of the general Nasdaq or NYSE rules described above (subject, in the case of Nasdaq, to a temporary “exceptional and limited circumstances” exception for one non-independent member); and
- independent within the stricter meaning of Rule 10A-3 under the Exchange Act.

Rule 10A-3 precludes a person from serving on the audit committee if the person:

- accepts, directly or indirectly, any consulting, advisory or other compensatory fees from the company (other than compensation for board service and certain retirement compensation); or
- is an “affiliate” of the company (a person who, directly or indirectly, controls, is controlled by, or is under common control with, the company).

While a person may be considered an affiliate of the company by virtue of his or her stock ownership, Rule 10A-3 contains a safe harbor for a person who does not beneficially own more than 10% of any class of voting equity security of the company and is not an executive officer of the company. If a person’s beneficial ownership exceeds 10%—an issue that often arises with respect to directors affiliated with venture capital or private equity firms that are investors in the company—all relevant facts and circumstances need to be examined to determine whether that ownership results in affiliate status. Beneficial ownership of 20% (post-offering) is often viewed as the upper bound for audit committee service.

COMPENSATION COMMITTEE— “ENHANCED INDEPENDENCE”

Nasdaq and NYSE rules require that each member of the compensation committee be independent within the meaning of the general Nasdaq or NYSE rules described above (subject, in the case of Nasdaq, to a temporary “exceptional and limited circumstances” exception for one non-independent member).

Both Nasdaq and the NYSE also require that, in affirmatively determining the independence of members of the compensation committee, the board must consider all factors relevant to determining whether a director has a relationship that is material to that director’s ability to be independent of management in connection with the duties of a compensation committee member, including:

- the source of compensation of such director, including any consulting, advisory or other compensatory fees paid by the company to such director; and
- whether such director is affiliated with the company.

Nasdaq and the NYSE have both indicated that ownership of company stock, even if it represents a controlling interest, does not automatically disqualify a director from service on the compensation committee.

COMPENSATION COMMITTEE— OTHER CONSIDERATIONS

There are additional benefits if the compensation committee members also satisfy two quasi independence standards under tax and securities law:

- *Tax Law:* Public companies can avoid the \$1 million cap imposed by Section 162(m) of the Internal Revenue Code on the deductibility of compensation income received upon the exercise of stock options and the vesting of restricted stock and restricted stock units if, among other things, the options or stock rights are granted by a compensation committee composed of at least two persons, each of whom is an outside director. For this purpose, an “outside director” is a director who:

- is not a current employee of the company;
 - is not a former employee of the company who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year;
 - has never been an officer of the company; and
 - does not receive remuneration from the company, either directly or indirectly, in any capacity other than as a director.
- *Securities Law:* A convenient way to exempt the grant of a stock option from the short-swing liability provisions of Section 16 of the Exchange Act is for the grant to be approved by a board committee composed of at least two persons, each of whom is a non-employee director. For this purpose, a “non-employee director” is a director who:
 - is not an officer or employee of the company or a parent or subsidiary of the company;
 - does not receive compensation, either directly or indirectly, from the company or a parent or subsidiary of the company for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed \$120,000 annually; and
 - does not possess an interest in any other transaction for which disclosure would be required pursuant to the SEC’s related-person transaction rules set forth in Item 404(a) of Regulation S-K.

NOMINATING AND CORPORATE GOVERNANCE COMMITTEE

NYSE rules require each listed company to have a nominating or corporate governance committee composed solely of independent directors under NYSE’s general definition of independence. While Nasdaq rules do not specifically require a nominating or corporate governance committee, most Nasdaq-listed companies have nominating and corporate governance committees consisting solely of independent directors under Nasdaq’s general definition of independence.

OTHER INDEPENDENCE DEFINITIONS

Other definitions of director independence are used by some parties, and need to be considered when assessing whether stockholders will vote in favor of the board’s nominees for directors or other board recommendations:

- *Proxy Voting Advisory Firms:* Institutional Shareholder Services (ISS) defines independence in a more stringent manner than the stock exchanges. For example, while Nasdaq and NYSE rules provide that a former executive may, after a three-year cooling-off period, be considered independent, under ISS’s definition a former founder or CEO can never be considered independent and other former executives cannot be considered independent during a five-year cooling-off period. Glass Lewis generally uses fewer bright-line tests than ISS, although it considers a director not to be independent if he or she owns or controls more than 25% of the company’s stock.
- *Institutional Investors:* Many large institutional investors have their own policies and definitions of independence.

CONTROLLED COMPANY EXEMPTIONS

A “controlled company”—defined as a company in which a majority of the voting power for the election of directors is held by an individual, a group or another company—is exempt from the requirements that:

- a majority of the members of the board of directors be independent;
- the board maintain a separate compensation committee consisting solely of independent directors, with prescribed duties, who satisfy the enhanced independence standards described above; and
- the board maintain a separate nominating committee consisting solely of independent directors, with prescribed duties.

A controlled company remains subject to all other corporate governance requirements imposed by SEC and stock exchange rules, including the maintenance of an independent audit committee. ■

18 SEC Review: What to Expect When You're Expecting to go Public

Form S-1 registration statements for IPOs are reviewed by the SEC staff before the offering can proceed. In general, a company's goal should be to complete the SEC review process as quickly as possible, to minimize disruption to its business and the duration of the quiet period during which its public communications are constrained. The SEC review process is outlined below, together with tips for managing the process.

NATURE OF REVIEW

"I'm from the government, and I'm here to help." Although often tongue-in-cheek, this statement is more true than not when it comes to the SEC review process.

Nearly every IPO Form S-1 receives a "full review" by the staff of the SEC's Division of Corporation Finance, or "Corp Fin" for short. As its name implies, a full review involves a comprehensive, cover-to-cover examination of the Form S-1 for compliance with applicable requirements of the federal securities laws and regulations.

The Form S-1 review is conducted within the Corp Fin "assistant director office" that corresponds to the company's industry. Corp Fin assigns two "examiners" to each Form S-1: a staff attorney to serve as the legal examiner and a staff accountant to serve as the accounting examiner. Each Form S-1 is also assigned one or more senior staff members—"reviewers"—to help achieve consistency in comments across reviews of multiple companies. There are separate reviewers for legal and accounting comments. The legal examiner assigned to the Form S-1 coordinates the review process for the SEC.

SEC review of a Form S-1 is focused on the company's compliance with applicable disclosure and accounting requirements. The SEC does not evaluate the fairness or substantive terms of an offering, or pass judgment on the prospects or nature of the company's business, or determine whether an investment is appropriate for any investor.

INITIAL COMMENT LETTER

The SEC's longstanding target is to provide comments on a Form S-1 within 30 calendar days after the initial Form S-1

filing (or confidential submission). In a slow market, initial comments can arrive in less than 30 days. When deal volumes surge, the 30-day standard occasionally may be missed by several days.

The legal and accounting examiners each spend several days or more reviewing the Form S-1 and preparing draft comments. The legal examiner conducts Internet searches on the company, browses its website, and reviews relevant industry publications and databases. The accounting examiner focuses on the company's financial and accounting disclosures and its compliance with accounting requirements. The review also involves reading the Form S-1 from a potential investor's perspective, posing questions that an investor might ask, and focusing on what may be missing from the filing.

The draft comments are provided to the reviewers for review and revision. The examiners then finalize the comments and combine them in a single comment letter. The staff's comment letter is usually addressed to the company and copied to company counsel, and is emailed to each in PDF format.

There are generally four types of comments:

- reminders about the Form S-1 process, such as the requirement to include a price range before circulating a preliminary prospectus, and the need to file all required exhibits, consents and opinions;
- comments relating to shortcomings in the drafting of the Form S-1, such as requests to condense the prospectus summary and make it more balanced, reduce repetition, make the risk factors specific to the company, and eliminate industry and technical jargon;
- requests for specific changes to the Form S-1 to comply with SEC rules or accounting requirements, or to clarify prospectus disclosures; and
- requests for substantiation or explanations of the company's disclosures or its application of accounting standards, which may or may not also require further changes to the Form S-1.

Initial letters routinely include 40–50 comments, but a larger or smaller number is not unusual. In any event, the nature of the comments is far more important than

the sheer number. Occasionally, the staff finds that a Form S-1 is so poorly prepared or beset with such serious problems that it declines to provide comments until a remedial amendment is provided.

INITIAL RESPONSE

Company counsel ordinarily is in charge of the overall response process and typically assembles the response letter; drafts many of the specific responses; coordinates input from the auditor, managing underwriters and underwriters' counsel; speaks with the examiners if clarification is needed; and works with the appropriate company personnel to develop or gather additional information as needed. Although it is acceptable to telephone the examiners to clarify an unclear comment, at this stage of the review process comments are raised and addressed in writing and not in meetings with the staff, or by telephone or email.

The response to the SEC's initial comment letter consists of two parts: an amendment to the Form S-1 reflecting changes based on the comments, as well as other updating and revisions; and a letter to provide requested information and to briefly explain the changes made to the Form S-1 in response to the staff's comments, including the reasons why the company does not believe changes are required in response to specific comments. In preparing the letter, the working group should be aware that the staff may request that any explanation included in the letter also be added to the Form S-1. Confidential treatment may be sought for appropriate portions of the response letter pursuant to SEC rules. In parallel with overseeing the preparation of the response letter, company counsel prepares the Form S-1 amendment, calling on other members of the working group for input as needed.

Once the working group is satisfied with the response letter and Form S-1 amendment, both are submitted to the SEC. "Courtesy copies" are usually sent directly to the examiners to assist them in their review of the revised Form S-1. These copies are in typeset form, which is easier to read than EDGAR output and should include blacklined versions to show all changes since the preceding filing.

The time required to assemble and submit a response to the SEC's initial comment letter

varies based on the nature and difficulty of the comments. At a minimum, the initial letter almost always includes a mix of legal and accounting comments and requests for additional information, and requires input from the company, counsel, auditor and managing underwriters. Some comments can be anticipated and responses prepared in advance, but other comments may raise unexpected issues that require substantial effort to address. Often it is also necessary to add financial statements for a recently completed fiscal period, triggering the updating of MD&A and many financial disclosures; if a new fiscal year has begun, updated executive compensation disclosure is also required. Two weeks is a reasonable target for submitting the first response in many offerings, but more time is needed in some IPOs, and less is possible in others.

SUBSEQUENT COMMENTS AND RESPONSES

Unlike its 30-day target for initial comments on a Form S-1, the SEC has not committed to any specific timing objective for the staff to review and comment on responses. The time required for SEC review depends on the number and nature of the staff's comments and the company's changes to the Form S-1, the quality of the company's response, staff workloads, the volume of SEC filings, and other factors. The SEC has informally indicated that its goal is to review and comment on the first Form S-1 amendment within ten business days. Additional time is often required, however, and it is not unheard of for the SEC's second set of comments to take as much time as, or more time than, the initial comments. Most examiners are willing to share their timing expectations with company counsel shortly after receiving the amendment and to fine-tune the expected timing as staff review progresses.

The SEC's review of the company's amended Form S-1 results in another, typically shorter, comment letter. Invariably, the staff is not satisfied with some of the company's responses and reiterates prior comments or requests additional information. The staff may also raise issues that were not discussed in its initial comments, sometimes prompted by the company's responses. After receiving the staff's second comment letter, the company prepares and submits

another response letter and Form S-1 amendment. As with the SEC's initial comment letter, the response is in writing and discussions between the examiners and company counsel are ordinarily confined to clarifications. The second response is ordinarily prepared more quickly than the first response—perhaps in a week, or even less—for several reasons. The number of unresolved comments should have declined, and although the staff can raise new issues at any time, the second round of comments generally does not present as many surprises as the initial set of comments.

This process continues until all SEC comments are resolved. Each iteration should get quicker as the number of comments dwindles, although this is not always the case if an overarching issue—usually an accounting matter—remains in play. When only a few comments are outstanding, most examiners will discuss proposed resolutions by telephone in order to help limit the number of formal filings, and some examiners may even entertain an informal submission of draft language. If the staff has reviewed an informal submission, at the end of the process the staff generally requires that all of the correspondence be finalized and submitted as EDGAR correspondence. Similarly, after supplying oral comments, the staff may ask the company to submit a letter summarizing the changes made in response to the comments. Upon resolution of all issues relating to the Form S-1, the staff orally advises company counsel that it has no further comments. Thereafter, the staff is not precluded from raising new issues or issuing more comments, but ordinarily does not do so unless further comments are precipitated by significant new information in another Form S-1 amendment.

CONFIDENTIAL SUBMISSION FOR EGCs

Under the JOBS Act, emerging growth companies (EGCs) are allowed to submit a draft Form S-1 to the SEC for confidential review, instead of filing it publicly on the SEC's EDGAR system. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements, signed audit reports and exhibits, but need not be signed by the company, its directors or its principal officers, include consents

from auditors or other experts, or be accompanied by the registration fee. The required signatures, consents and registration fee are provided upon the first public filing. An EGC that confidentially submits a draft Form S-1 must publicly file the Form S-1 at least 21 days before beginning the road show. Most EGCs take advantage of the confidential review process.

The SEC review process, including the number of comment letters issued by the staff and the overall timeline to complete staff review, is generally the same for EGCs electing confidential SEC review and for companies undergoing a traditional filing and review process. The principal difference is that, with a confidential submission, part of the review process occurs before any public filing is made.

"APPEALS" AND WAIVERS DURING REVIEW PROCESS

In many IPOs, staff review is concluded more or less in the fashion described above, but other offerings encounter bumps in the review process, usually because of an inability to resolve one or more staff comments. If the company and staff reach an impasse during the review process, the company may ask that a staff position be reconsidered or may seek a waiver of an accounting or disclosure requirement. The process for doing so depends on the nature of the comment or requirement, the time constraints faced by the company, and the strength of the company's position.

SEC Review—A Snapshot

Based on median data for all US IPOs between 2007 and 2014, the typical company had:

- Initial comment letter, containing 42 comments, in 27 days
- Total of four comment letters, with fewer comments and quicker turnaround each time
- Comments focusing on financial statements (16%), MD&A (15%), business (11%), prospectus summary (11%), risk factors (9%) and executive compensation (7%)
- Overall timeline from initial filing to effectiveness of 116 days

An important first step is to make sure the company understands the staff's comments and has responded completely. Frequently, the examiners continue to issue comments if they do not believe that the response is complete. If a comment is unclear, or is reissued after the company submits a thorough response, company counsel should call the examiner to discuss what is being requested. If the company does not understand the comment after discussing it with the examiner, it can seek further clarification from the assigned reviewer. Sometimes these steps lead to a quick resolution. To facilitate these communications, the names and telephone numbers of the staff members involved in the review are included in each comment letter.

If the company understands a comment, has responded completely, and simply disagrees with the staff, it is appropriate to advise the examiner that the company would like the staff's position to be reconsidered by the reviewer. Corp Fin does not prescribe a formal protocol for seeking reconsideration of a staff comment, and a request may be oral or in writing. A telephone conference with the examiner and reviewer to explain the company's position and answer any questions is often helpful. If requested, such a call can usually be arranged within a few days, and it is often useful for the company to submit a succinct "talking points" memorandum in advance of the call to recite the facts and frame the company's position.

If, after these discussions, the staff continues to take a position with which the company disagrees, the company may continue this process with higher-level supervisors. While it is possible that the examiner already will have consulted with more senior staff, specifically requesting that senior staff get involved and engaging in a dialogue with them often can help resolve the issue. At all times, it is important to let the examiner know that the company is going "up the ladder," so that he or she is not surprised by a call from a supervisor. It is generally not productive to stop working with the review staff or to call senior staff members or the SEC chair's office to try to forestall staff comments.

Accounting and Financial Disclosure Comments

Reconsideration of accounting and financial disclosure comments normally begins with the applicable accounting branch chief in the assistant director office and then proceeds to the office's senior assistant chief accountant. An unresolved matter may then be addressed to the associate chief accountant in Corp Fin's Office of Chief Accountant (CF-OCA). If necessary, requests for further reconsideration may be directed to Corp Fin's deputy chief accountant or chief accountant. Before taking an issue beyond the accounting examiner, the company should make sure that the response letters contain a clear, understandable and complete discussion of the company's position and the relevant accounting literature. Once CF-OCA is involved, the time required to complete the process will vary depending on staff workload and the complexity of the issue. In general, however, the staff responds within a few weeks. If the company has specific time constraints, it should make those limitations known and ask that the staff try to accommodate its needs.

A request for reconsideration of an accounting or financial disclosure comment sometimes leads to a waiver request. The staff in CF-OCA considers written requests for waivers of accounting requirements under SEC rules, but does not waive GAAP requirements. To request a waiver, the company or its counsel submits a letter to CF-OCA with a complete factual description and an explanation of why the waiver is necessary and consistent with investor protection. It is usually best to discuss the submission with the staff in that office in advance. As with other staff correspondence, confidential treatment may be sought for appropriate portions of a waiver request. The company will receive a written response to its request. In general, the staff in CF-OCA strives to respond to waiver requests within ten days.

If the company asks for reconsideration of an accounting or financial disclosure comment or a waiver of an accounting requirement, it is important to make sure that the company's auditor agrees with the company's position. The staff often asks if the company's auditor concurs with the company's position, particularly on accounting requirements. If the

company and its auditor do not agree, it is very difficult to persuade the staff to agree with the company's position. The staff also may inquire whether the company's audit committee has been consulted and is in agreement.

Sometimes Corp Fin staff refers an accounting or financial disclosure issue to the SEC's Office of the Chief Accountant (which is different than CF-OCA), or advises the company that it can ask that office to reconsider a staff position. The required procedures for consideration of an issue by the SEC's Office of the Chief Accountant are spelled out on the SEC's website. The procedures state that a company can expect a response two to three weeks after its initial submission—later if the initial submission is incomplete or the follow-up submission is delayed, and sooner if the first submission is thorough and no follow-up is required.

Legal Issues and Disclosure Comments

The same general approach is followed when the company seeks reconsideration of staff positions on legal issues and disclosure comments. In most cases, company counsel should be able to resolve disclosure issues with the review staff, and on legal issues the review staff may involve the staff in Corp Fin's Office of Chief Counsel. If reconsideration of a staff position is sought, the process normally begins with the legal branch chief in the assistant director office and then proceeds to the assistant director. Further reconsideration can be sought from the Corp Fin associate director who oversees the assistant director office, and then from Corp Fin's deputy director and director. In general, it is not possible to obtain an outright waiver of a disclosure requirement; if the company wants to avoid disclosure, it needs to convince the staff that disclosure is not material and thus not required.

The Bottom Line

There is nothing wrong with seeking reconsideration of staff positions, or requesting a waiver. The staff will not resist, become offended, or retaliate against the company. Throughout the reconsideration or waiver process, however, the company must weigh the importance of the issue against the impact of the delay on the offering and choose its battles wisely. Time is the ultimate leverage, and it does not favor the company. Because of this reality, as a practical matter the staff usually has

the final say on every point of contention. Reconsideration is rarely pursued all the way up through the entire potential chain of appeals, and issues are frequently conceded in order to conclude staff review and get to market on the desired schedule.

TIPS FOR A SMOOTH REVIEW PROCESS

SEC review proceeds most smoothly when it is approached in a collaborative rather than adversarial manner. Corp Fin views the review and comment process as a “dialogue” with the company about its disclosure. The purpose of SEC review is to assist the company in its compliance with the applicable disclosure requirements and to enhance the overall disclosure in the Form S-1. It is not the SEC’s intention or desire to delay the offering, but the staff does take very seriously its role of investor protection and under this banner insists on disclosure it considers full and fair. Occasional frustration or unhappiness during SEC review is not uncommon, but it should not be allowed to spill over into communications with the examiners.

With few exceptions, staff communications regarding the Form S-1 review should be conducted through company counsel. If an accounting or financial disclosure issue remains unresolved after several rounds of comments and a conference call discussion is held with the accounting examiner, the company’s CFO or chief accounting officer, and often its auditor, should also participate. In general, however, no member of the working group should contact the examiners directly except for a specific purpose and with the approval of company counsel. Channeling all communications through company counsel enables more control over the process, and company counsel ordinarily has the most experience in SEC dealings and often develops a helpful rapport with the staff.

DEALING WITH THE STAFF

The company and its counsel should be mindful of several simple guidelines in working with the staff:

- *Candor:* There is no upside to being less than forthright in response to staff comments or questions. The company cannot decline to supply requested information on the grounds

that it is confidential or immaterial. Examiners expect a high degree of integrity from company counsel, and a significant shortfall could undermine counsel’s credibility and impede the resolution of comments.

- *Communication:* Open communication is a must, since the staff cannot read minds. Legitimate needs should be made known to the staff in a timely fashion. Requests for clarification make more sense than guessing incorrectly at what a comment means. Keep the examiners informed of the offering’s proposed timing and significant changes.
- *Courtesy:* As a matter of simple courtesy, treat the staff in a polite and professional manner and avoid surprises. Give the staff a heads-up before submitting a Form S-1 amendment with unexpected or very unusual disclosures. If it is necessary to escalate an issue, let the examiner know in advance.

MANAGING THE TIMELINE

The most common concern with SEC review is timeliness. Although initial comments are usually provided on schedule, the timing of staff review of the company’s first response and amended Form S-1 is less predictable, partly due to variability in the nature of the comments and the quality

of the submission, but also due to factors such as workload, filing volumes, and even staff vacation schedules and parental leaves. The timeline of the balance of the review is even more difficult to predict, since a single unresolved issue can delay the completion of the process. To a company that is eager to start the road show and close the offering, the review process may seem interminable.

Once the review process is underway, the company’s best strategy is to provide complete amendments and responses as soon as practicable after each set of new comments, while keeping the staff informed of the offering’s anticipated timing. Prompt responses help convey a sense of controlled urgency. If the company fritters away weeks before responding, it becomes more difficult to prod the staff to meet deadlines.


If the staff is unusually slow in responding, or is not returning telephone calls, it is acceptable for company counsel to call the examiner’s supervisor or another staff member identified in the comment letter, after alerting the examiner. If that approach fails to generate a response, a call to the applicable assistant director or one of Corp Fin’s associate directors may be necessary. In all these calls, it is important to note how much time has passed since the company’s last response, and any relevant timing constraints. ■

How Long Does All This Take?

DESCRIPTION	MEDIAN (CALENDAR DAYS)	25TH–75TH PERCENTILES (CALENDAR DAYS)
Overall timing from initial Form S-1 filing (or confidential submission) to effectiveness	116	91–175
Initial Form S-1 filing (or confidential submission) to first comment letter	27	27–28
First comment letter to first Form S-1 amendment	14	9–19
First Form S-1 amendment to second comment letter	15	13–17
Second comment letter to second Form S-1 amendment	9	6–16.25
Second Form S-1 amendment to third comment letter	12	7–15
Third comment letter to third Form S-1 amendment	7	4–16
Third Form S-1 amendment to fourth comment letter	8	5–13
Fourth comment letter to fourth Form S-1 amendment	5	3–10

Source: WilmerHale analysis of SEC filings for all US IPOs completed between 2010 and 2014 (overall timing based on 2007–2014 data). Data reflects total elapsed time, including delays due to market conditions and other reasons that may be unrelated to SEC review.

22 Key Regulatory Diligence in an IPO

 Most companies are subject to a variety of regulatory requirements on both an ongoing and episodic basis. These requirements range from routine obligations, such as those imposed by employment laws, to high-profile regulatory obligations, non-compliance with which can result in severe consequences. Many regulatory requirements apply to all companies, while others are industry-specific.

As part of its IPO preparations, a company going public should assess its regulatory compliance. Internal due diligence on regulatory compliance in advance of an IPO can help a company identify and address deficiencies, establish appropriate systems and procedures going forward, craft appropriate risk factor and other disclosure for the Form S-1, and prepare for underwriter due diligence. Pre-IPO remediation of regulatory violations can also help reduce the likelihood of stockholder litigation and enforcement action following the IPO. Summarized below are several key areas of regulatory diligence.

PRIVACY AND DATA SECURITY

Nearly all companies maintain information (such as employee and customer data) that is subject to privacy regulation, and many companies handle sensitive personal information (such as consumer financial or health data) in their business operations. Companies must ensure that appropriate notice, access, choice, security and enforcement measures are in place.

Personal information is governed by a patchwork of data protection regulations that impose privacy standards, security safeguards and procedures for handling security breach incidents. Most privacy regulatory systems implement elements of the so-called Fair Information Practice Principles, which contemplate that personal information will be collected, used and disclosed pursuant to a notice describing the relevant data processing activity; a right to access and amend one's information; a right to elect or reject secondary uses of personal information; a system of safeguards to maintain the security and integrity of the information; and a mechanism for submitting

complaints and resolving disputes involving the use of personal information.

In the United States, numerous federal and state laws govern the data that companies collect, maintain and disclose. The Federal Trade Commission asserts general authority over data-handling practices that might constitute unfair or deceptive commercial practices, such as noncompliance with stated privacy policies. Health information is affected by the federal HIPAA health data regulations; nonpublic consumer information is subject to privacy and security rules under the Gramm-Leach-Bliley Act or Payment Card Industry standards; information collected and used for advertising is subject to special consideration; and other rules govern commercial email. In addition, individual US states have adopted a wide range of their own (often inconsistent) privacy and data security requirements.

Companies with non-US operations must comply with global data protection requirements. For example, a sweeping European Union directive presumptively prohibits transfers of personal data to the United States unless a specific exception or protective methodology applies.

Inadequate data-handling practices can expose a company to criminal and civil liability. In addition, companies must consider their disclosure obligations—both in the Form S-1 and in post-IPO filings with the SEC—relating to cybersecurity risks and data security breaches. In mid-2014, it was reported that the SEC had commenced investigations of “multiple companies” to examine their handling and disclosure of cyberattacks.

TRADE COMPLIANCE

Companies with international operations (whether foreign customers or foreign suppliers) are subject to a variety of trade compliance requirements.

Anti-Corruption. The Foreign Corrupt Practices Act (FCPA) prohibits any company, whether private or public, as well as its officers, directors, employees, stockholders and agents, from making or offering corrupt payments to foreign government officials. FCPA compliance is particularly important because the

company's directors and officers can be personally liable for FCPA violations. Enforcement of the FCPA is a priority for both the Department of Justice and the SEC, which maintains a specialized FCPA unit. Companies operating overseas must comply with similar foreign laws, such as the UK Bribery Act 2010. Uncorrected foreign bribery issues that persist after the IPO may expose the company to SEC enforcement action.

Anti-Money Laundering. US and foreign anti-money laundering (AML) laws and regulations are intended to safeguard the global financial system from financial crimes, including terrorist financing and other illegal activities. In the United States, the Bank Secrecy Act requires covered institutions to implement measures to detect and prevent money laundering, including mandatory reporting of suspicious and large cash transactions. The USA PATRIOT Act added enhanced due diligence requirements and mandatory AML compliance programs for a wide range of financial services businesses.

Economic Sanctions. The United States administers economic sanctions that prohibit or impose licensing requirements for transactions with targeted countries, companies, organizations and individuals. These sanctions are administered by the Office of Foreign Assets Control (OFAC) in the Department of the Treasury. With only limited, narrowly construed exceptions, OFAC's regulations prohibit most transactions involving Cuba, Iran, Sudan, Syria and the Crimea region of the Ukraine. The regulations also implement less comprehensive sanctions programs that target specific governments, entities and individuals in numerous countries. In addition, OFAC prohibits transactions with certain Specially Designated Nationals (SDNs), who may be located in or nationals of countries that are not otherwise restricted.

OFAC regulations have broad reach. They prohibit US persons from approving or facilitating any transaction by foreign persons that cannot be conducted directly by US persons. The sanctions against Cuba and Iran also cover activities of foreign-incorporated entities that are owned or controlled by US persons. Moreover, sanctions that prohibit transactions

with SDNs also prohibit dealings with entities that are majority-owned by a designated SDN. Violations are subject to criminal and civil enforcement.

Newly public companies must be especially attentive to OFAC compliance because the SEC's Office of Global Security Risk (OGSR) routinely directs public companies to explain their activities with sanctioned countries, entities and individuals. Such activity may become apparent to OGSR through SEC filings, the content of companies' public websites, media reports or public information referring to OFAC licensing or enforcement activity. OGSR's inquiries are not limited to conduct that is prohibited by OFAC regulations, and public companies must be prepared to disclose and justify activity that might be conducted by foreign affiliates entirely outside of the reach of OFAC's regulations.

OFAC administers a voluntary disclosure program under which companies can obtain more favorable treatment in enforcement proceedings if they disclose apparent violations before they otherwise become known to regulatory authorities. Certain sanctioned activity, however, is subject to mandatory disclosure. For example, issuers must disclose whether they knowingly engaged in or conducted certain activities relating to Iran or the Iranian government, or with certain SDNs that are associated with terrorism or weapons of mass destruction. If past conduct that might have violated OFAC prohibitions is required to be disclosed in the Form S-1, it may be advisable to voluntarily disclose this information to OFAC before filing the Form S-1 with the SEC.

Export Control. Distinct from the OFAC restrictions, international transfers of products, equipment, materials, software, technology and services may be subject to export control regulations that carry their own enforcement risks. Violations of export control regulations are subject to corporate and individual criminal liability and civil money penalties. Administrative sanctions can include onerous consent agreements requiring long-term compliance monitoring, or suspension of a company's export privileges entirely.

US export control regulations are principally overseen by the Department of State, whose Directorate of Defense Trade Controls administers the International Traffic in Arms Regulations (ITAR) that regulate defense articles and defense services of particular military significance; and the Department of Commerce, whose Bureau of Industry and Security administers the Export Administration Regulations (EAR) that regulate "dual-use" commodities, software and technology with both civil and military applications.

Companies that manufacture, export or broker articles or furnish services subject to ITAR must register with the Department of State. Export and brokering activities of companies subject to ITAR can be conducted only pursuant to Department of State licensing. Notably, export controls apply when controlled software or technology is released to foreign persons who may be living or working in the United States—these "deemed exports" are a significant source of regulatory exposure for companies.

Exports of dual-use commodities, software and technology may be subject to EAR licensing requirements, which vary widely according to the nature and technical characteristics of the item, the country of destination, the intended end user, information about the likely end use of the exported items, and the availability of numerous "license exceptions" that override otherwise-applicable licensing requirements. Special administrative requirements, including mandatory registration, product classification and post-export reporting requirements, apply to exporters of encryption commodities, software and technology. Even companies that export only items obtained from third parties must ascertain the regulatory status of all such items, since export requirements apply to the party undertaking the export transaction, as opposed to the vendor or supplier.

The ITAR and EAR export control regimes both impose recordkeeping and documentation requirements, offer optional advisory services to resolve questions about regulatory jurisdiction and regulatory classifications, and administer self-disclosure programs that contemplate favorable handling

of enforcement matters arising from voluntarily disclosed violations.

Although disclosures of export violations are generally voluntary, an important exception requires immediate, mandatory disclosure to the Department of State if a company knows or has reason to know of a "proposed, final, or actual sale, export, transfer, reexport, or retransfer of articles, services, or data" directly or indirectly to countries subject to US arms embargoes without ITAR licensing. The countries currently subject to US arms embargoes are Afghanistan, Belarus, Burma, China, Cote d'Ivoire, Cuba, Cyprus, Democratic Republic of the Congo, Eritrea, Fiji, Haiti, Iran, Iraq, Lebanon, Liberia, Libya, North Korea, Somalia, Sri Lanka, Sudan, Syria, Venezuela, Vietnam, and Zimbabwe.

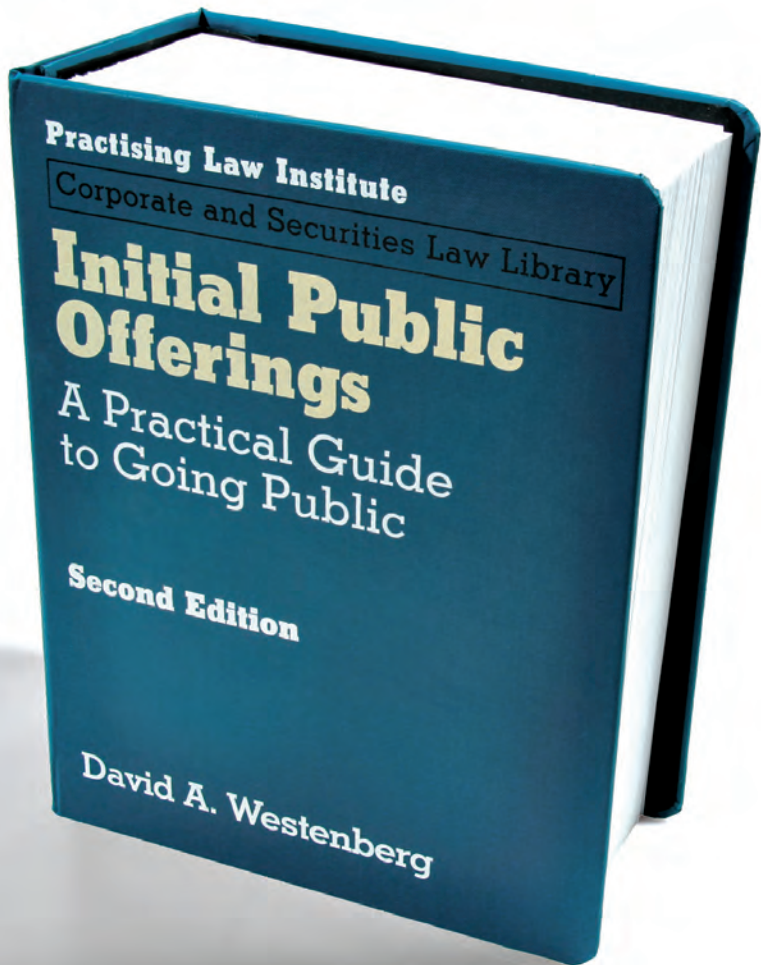
The health of a company's global business often depends significantly upon compliance with applicable export control regulations. As a result, appropriate jurisdictional determinations, product classifications, transaction screening procedures, license administration, contractual compliance assurances and internal compliance oversight measures need to be in place.

Anti-Boycott. The EAR also contains provisions that implement US anti-boycott regulations. The anti-boycott provisions are intended to prevent US persons and businesses from participating in unsanctioned foreign boycotts, principally the Arab League's boycott of Israel. With only limited exceptions, US companies are required to report to the Department of Commerce any request to cooperate with a non-US boycott, and are forbidden from cooperating with boycotts that are unauthorized.

Related IRS regulations require taxpayers to report any "operations" in, or related to, countries that administer international boycotts. The currently recognized boycotting countries are Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen. Operations in other countries must also be reported if a company knows or has reason to know that participation in or cooperation with an international boycott is required as a condition of doing certain business with that country. ■

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