Roadmap for an IPO

A Guide to Going Public

*connectedthinking

About PricewaterhouseCoopers' Business Advisors

Whether your company is an emerging business seeking venture capital, or an established company seeking to expand through an initial public offering, you can rely on PricewaterhouseCoopers for a full range of support services.

PricewaterhouseCoopers' global presence, extensive knowledge of capital markets, and network of financing relationships provides you the expertise and insight you need at every stage.

Since PricewaterhouseCoopers is the first choice for assurance and tax consulting services among the nation's top 100 technology-based venture capital firms, we are knowledgeable about the issues that arise between entrepreneurs and venture capitalists — and the challenges faced by fast-growth companies.

We excel at:

— Assisting you in identifying financing sources;
— Ensuring you have proper controls and processes in place to comply with Sarbanes-Oxley;
— Serving as your advisor as you prepare for an IPO or position yourself to be acquired;
— Providing due diligence and structuring services for M&A.

If you'd like to contact the nearest PricewaterhouseCoopers business advisory expert, please call our Hotline at 1-877-PwC-TICE or visit our Web sites:

www.pwc.com/technology

www.pwcV2R.com (VisionToReality site for entrepreneurs)

www.pwc.com/ustransactionservices

Table of Contents

	Page
Introduction	1
1. The Going-Public Decision	2
2. Current Regulatory and Disclosure Issues	12
3. Preparing for a Successful Offering	16
4. Choosing Your Investment Banker	24
5. The Going-Public Process	34
6. Life as a Public Company	52
7. Other Considerations	58
Conclusion	75
Appendix A – The SEC and Securities Regulations	79
Appendix B – Detailed Going-Public Timeline	85
Appendix C – Glossary	89

TIP

All too often going public is viewed as the only means, rather than one of several useful business alternatives, to achieve a company's objectives. Accountants can provide the expertise that will enable you to make an informed, intelligent, and objective decision.

Introduction

Going public is a monumental decision for any company. It forever changes how a company goes about doing business. The actual process of going public can be time-consuming, expensive, and take a substantial amount of key management focus away from the day-to-day operations of the company.

With the IPO market window beginning to open once again, and the significant changes in public company reporting resulting from the Sarbanes-Oxley Act of 2002, we are publishing this fourth edition, addressing the numerous provisions of Sarbanes-Oxley impacting public companies and the IPO process.

This publication attempts to present the information that a company will need when it debates whether or not to go public or to pursue alternate means to finance growth. The purpose of the guide is to assist you in making an informed decision by addressing such factors as the advantages and disadvantages, costs, timing, and the alternatives to going public. It outlines the "process" of going public, discusses the registration and ongoing reporting requirements of a public company, and provides an overview of the securities markets. Finally, the guide summarizes the most significant accounting, compensation, and tax-related considerations of going public.

1 The going-public decision

What does "going public" mean? It is the process of offering securities — generally common or preferred stock or bonds — of a privately owned company for sale to the general public. The first time these securities are offered is referred to as an initial public offering or IPO.

Public offering

An IPO in which a company sells its unissued securities and receives all the proceeds in the form of additional capital is called a primary offering. A securities sale in which securities held by the owners of the company are sold, and from which the owners receive the proceeds, is called a secondary offering. IPOs are almost always primary offerings, but may include a small number of shares held by the present owners.

Why am I going public?

The most important question a CEO should ask is, "Why do I want to go public?" Some of these reasons are:

- To raise money for expansion of operations
- To increase market value
- To acquire other companies
- To attract and retain employees
- To diversify and liquefy personal holdings
- To provide liquidity for shareholders
- To implement an estate tax-planning strategy
- To enhance the company's reputation

Other reasons may be private and personal. It is truly important to recognize your reasons and to keep your goals in mind throughout the going-public process.

Is going public right for your company?

A company usually begins to think about going public when the funding required to meet the demands of business expansion begins to exceed its ability to raise additional private/venture capital funding or debt capacity. But simply needing capital does not always mean that going public is the right, or even possible, answer. Your company must also be perceived as an attractive investment candidate.

How can you determine if your company is a public offering candidate? Your answers to the following questions can help.

Does your company have an attractive track record?

Generally, a company that outpaces the industry average in growth will have a better chance of attracting prospective investors than one with marginal or inconsistent growth. Some underwriters consider a company to be an IPO candidate if it has annual revenues of at least $50 million and profitability of $1 million or more. Even so, many early-stage technology companies also have successfully gone public. The Internet has created an opportunity for many of these early-stage technology companies to exponentially grow their business in a very short time as compared with more "traditional" companies. Though they may not currently exhibit a strong growth rate, investors perceive these companies as having enormous potential for growth because of the other favorable characteristics they possess (e.g., product or service that is highly visible, unique or of interest to the public, and capable and committed management).

TIP

Begin early to position your company to go public by ensuring that a sufficient number of years of audited financial statements (three years minimum) are available before starting the IPO process. You will save fees, headaches, and, most importantly, time. The earlier you are ready to enter the market, the likelier you will be to meet an opportune market and the greater proceeds and market valuation that favorable market conditions provide. It is also advisable to establish, document, and evaluate internal controls, and to implement accounting and information systems that can handle anticipated growth in the business and financial reporting obligations, including accurate and timely interim financial statements and management's evaluation and reporting on the effectiveness of internal controls over corporate reporting.

Early preparation in establishing stock option plans, simplifying capital structure, and conducting corporate "housekeeping" can be performed much more easily before starting the IPO process. However, exercise care with shares or options granted within three years, and particularly within twelve months, prior to an IPO at prices less than the anticipated IPO price. This is potentially dilutive to the company's outstanding shares and its earnings per share amounts. Also, additional compensation expense may need to be recorded if the fair value of the stock at the grant date is later determined to have exceeded the options' exercise price. One way to help minimize this risk is to seek competent accounting advice and to obtain a contemporaneous appraisal of your company's stock price at the time the option grant occurs. (See "Current Regulatory and Disclosure Issues," page 12, for further information).

Has your company received venture capital funding?

Many early-stage companies that do not have a proven track record increase credibility and can validate their business concept, product, or service before they go public by selling a portion of their equity to venture capitalists. Investment from venture capital sources is viewed as "smart money" which can also help increase valuation leading up to an IPO.

Has your company reached the point where prospects for maintaining a strong sales and earnings growth trend in the future are reasonably good?

Many companies that have successfully gone public have shown market support for their product or service that would sustain an increasing annual growth rate for a five-year period. This growth potential should be even larger if institutional investors are expected to buy significant blocks of shares in the company. Again, the exception might be the early-stage technology company that has developed to the point that the risks usually associated with a venture capital investment — product development, manufacturing capability, market acceptance, and market size — have been reduced.

Are your company's products or services highly visible and of interest to the consuming and investing public?

The established company can answer this question with historical sales data, while the early-stage company must use market research projections and demonstrated product superiority. In fact, the early-stage company usually qualifies as an IPO candidate because of the uniqueness of its product or service.

Has your company developed the necessary financial processes, associated internal controls, and financial statement integrity to support management's reporting obligations as a public company?

The Sarbanes-Oxley Act of 2002 (SOA) was enacted on July 30th, 2002, largely in response to a number of major corporate and accounting scandals involving some of the most prominent companies in the United States. SOA, among other things, established a new requirement that CEOs and CFOs explicitly evaluate and report to the public on the effectiveness of specified internal controls over corporate reporting. Additionally, on an annual basis, the company's external auditor is required to attest to management's assertions about the internal controls and procedures for financial reporting.

Is management capable and committed?

In any public offering, the quality of the management team is a key factor. To have credibility with the investing public, the organization must have experienced leadership that functions well as a team. In addition, ownership by management demonstrates to investors that it has a vested interest in

the company's future. In order to have a successful IPO, management must be committed to the time and effort involved in meeting registration requirements, conducting analysts' meetings, and providing financial reports required for both the SEC and shareholders on a timely basis. It must also be prepared to upgrade the company's system of management controls and financial reporting to ensure compliance with full disclosure requirements and shorter financial reporting deadlines, both of which are necessary to maintain credibility and investor confidence after the IPO.

Do the benefits outweigh the costs of going public?

Selling equity represents a permanent forfeiture of a portion of the returns associated with corporate growth. Also, raising equity capital in the public markets can entail substantial costs, such as the underwriting discount, plus other fees and expenses. (See the discussion on costs that appears later in this section.) However, the answer to whether the benefits outweigh the cost cannot be realistically known until several years after an IPO.

Is the market right?

The demand for initial public offerings can vary dramatically, depending on overall market strength, the market's opinion of IPOs, industry economic conditions, technological changes, and many other factors. When a bull market is booming, the market window for new corporate offerings tends to open and these new offerings enjoy bursts of popularity. In a declining market, however, the market window tends to close and IPO activity slows down and may even come to a dead stop. Although no one can accurately forecast the market's mood, you must consider the importance of timing and be prepared to alter your company's timetable. The usual time, from the initial meeting of all of the team members until completion of an offering, can take three (under the best circumstances) to five months.

Hot markets accept many offerings, but you do not want to be the deal that is just one day too late. Recognizing the urgency of the registration process is critical. Even in a slower market environment, there is what is referred to as an "industry pop" or "industry flurry." Recent occurrences of this phenomenon have involved Internet companies. "Industry pops" are tricky since you may be perceived as a "me too" company and not as strong as the leader and when interest wanes, the window of opportunity closes quickly. However, "industry pops" give the public investor good current information on comparable companies in order to make valid pricing decisions.

Market conditions will also impact the valuation of your company and the eventual pricing of its stock.

The downturn in the market that commenced in the spring of 2000 is reflected in the significantly smaller number of IPOs occurring between 2001 and 2003. Data from the SEC shows the following annual figures for the number of IPOs, the gross proceeds raised, and the average size of the offerings:

Year	Number of IPOs	Gross Offering Proceeds Raised (in Billions)	Average Offering Size (in Millions)
2003	81	$15	$187
2002	86	$26	$300
2001	96	$37	$389
2000	380	$59	$156
1999	505	$61	$122

Source: Thomson Financial. Common stock. All IPOs.

Pros, cons, and expenses of going public

All in favor…

— Cash/long-term capital
These are obtained to support growth, increase working capital, invest in plant and equipment, expand R&D, and retire debt, among other goals.

— Increased market value
The value of public companies tends to be higher than that of comparable private companies due in part to increased liquidity, available information, and a readily ascertainable value.

— Exit strategy
Liquidity and greater shareholder value may be achieved for the shareholders. Subject to certain restrictions and practical market limitations, shareholders may, over time, sell their stock in the public market. Alternatively, existing stock may be used as collateral to secure personal loans.

— Equity offerings
An IPO increases corporate net worth, does not need to be repaid, and may permit additional borrowing on more favorable terms because of an improved debt-to-equity ratio.

— Prestige/reputation
The visibility for shareholders and their company is usually enhanced. For example, a regional company may more easily expand nationally following a stock offering due to the increased visibility.

— Ability to attract and keep key personnel
If a company is publicly owned, employee incentive and benefit plans are usually established in the form of stock ownership arrangements to attract and keep key personnel. Stock option plans, for example, may be more attractive to officers and other key personnel than generous salary arrangements due to the significant upside potential.

— Less dilution
Provided your company and the market are ready, you may achieve a better price that results in less dilution compared to other forms of equity financing.

— Mergers/acquisitions
These activities may be achieved with stock transactions and thus conserve cash.

All opposed…

— Expenses
Many factors play a role in determining the cost of an IPO, but in all cases these costs are significant. Outlined in the table below is the range of IPO costs that should be expected if you decide to go public. Expenses of a completed IPO are reflected as a reduction of additional paid-in-capital and, therefore, are not expensed in the statement of operations. However, if the IPO is not completed, such costs must be expensed.

Cost	Range
Legal	$600,000 – $800,000
Accounting	$400,000 – $600,000
Printing	$150,000 – $200,000
Blue sky	$10,000
Transfer agent/registrar	$5,000
Miscellaneous	$60,000
Underwriters' discount and commission	Typically 7% of the aggregate offering proceeds
SEC filing fee	$278 per $1 million of the aggregate offering amount
NASD fee	$500, plus .01% of the aggregate offering amount. The maximum fee is $30,500.
NASDAQ national market	$5,000 plus a decreasing marginal fee per million shares listed

TIP

Companies may wish to implement incentive stock option plans, which are more attractive for management of public companies because of a readily known market price. These plans are a tax-advantaged benefit to employees. Employees can avoid paying taxes until they sell the shares, compared with the "upon exercise" rules of non-qualified stock option plans. However, exercise care to ensure that proper legal, accounting, and tax issues have been addressed on option or stock award plans. Unaddressed issues may lead to future unpleasant surprises in the form of additional expenses and lower net income and earnings per share.
(See "Current Regulatory and Disclosure Issues," page 12, for further information.)

Example: A company selling $100 million of common stock, with twenty million shares outstanding, may pay the following fees:

$7,000,000 underwriting fee
$27,800 SEC fee
$10,500 NASD fee
$95,000 NASDAQ fee
$1,225,000 – 1,675,000 prep fees (legal, accounting, etc.)
$8.4 – $8.8 million total expenses
$100 million offering proceeds
$ 8.4 – $8.8 million expenses
$91.2 – $91.6 million net proceeds to the company

— Ongoing expenses
As a public company you are required to report and certify financial information on a quarterly and annual basis. Ongoing expenses related to this include administrative and investor relations costs including quarterly reports, proxy material, annual reports, transfer agent, and public relations. You will now be paying premiums for directors' and officers' liability insurance as well.

— Loss of control
If more than 50 percent of a company's shares are sold to just a few outside individuals, the original owners could lose control of the company. If, however, the shares held by the public are widely distributed, management may maintain effective control, even though it owns less than 50 percent of the shares. Many companies structure their offerings so that after an initial offering, the founder(s) still has control and after subsequent offerings the entire management team maintains control.

— Loss of privacy
The registration statement and subsequent reports require disclosure of many facets of your company's business, operations, and finances that may never before have been known outside the company. Some sensitive areas of disclosure that will be available to competitors, customers, and employees include: (1) the compensation of officers and directors, including cash compensation, stock option plans, and deferred compensation plans; (2) the security holdings of officers, directors, and major shareholders (insiders); and (3) extensive financial information (e.g., financial position, sales, cost of sales, gross profits, net income, segment data, related-party transactions, borrowings, cash flows, major customers, and assessment of internal controls).

- Pressure for short-term performance
  In a private company, the business owner/manager is free to operate independently; however, once the company becomes publicly owned, the owner acquires as many partners as the company has shareholders, and is accountable to all of them. Shareholders expect steady growth in areas such as sales, profits, market share, and product innovation. Thus, in a publicly held company, management is under constant pressure to balance short-term demands for growth with strategies that achieve long-term goals. Further, often the inability to meet analysts' expectations of short-term earnings can dramatically hurt the marketplace's long-term valuation of your company.

- Restrictions on insider sales
  Stock sales by insiders are usually limited. Most underwriters require that a company's existing stockholders enter into contractual agreements to refrain from selling their stock during a specified time following the IPO, typically 180 days. This is considered the "lock-up" period.

- Investor relations
  Investors' inquiries, investment-community presentations, and the printing and distribution of quarterly and annual financial reports require a significant time commitment by management. They often also require additional personnel or public relations resources.

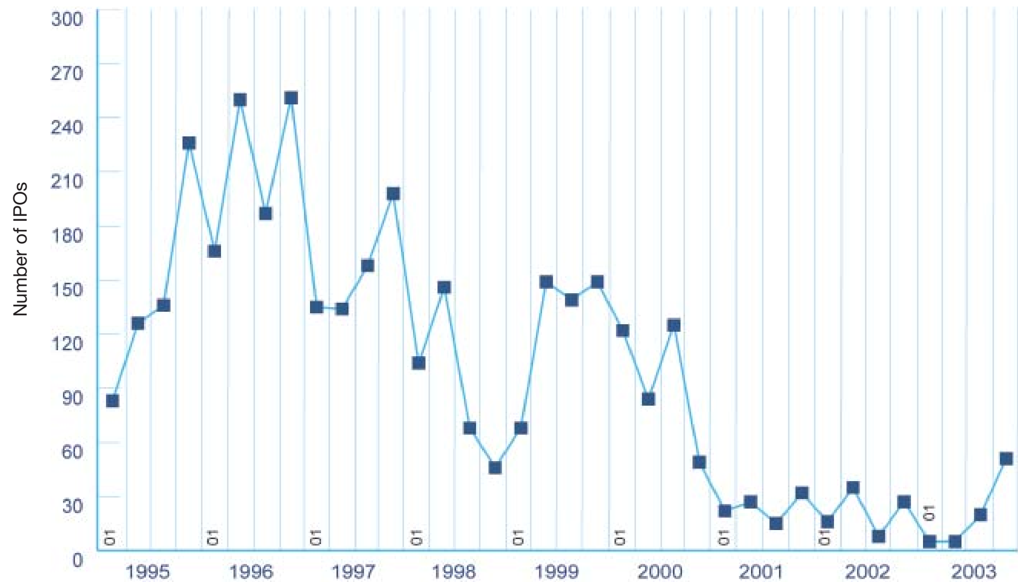
- No turning back
  The IPO process is essentially one way. Taking your company private again can be difficult and costly.

Timing – the IPO "window"

The stock market is one of the most unpredictable aspects of going public. The term "market window," which refers to the appetite and capacity of the stock market to complete IPOs, opens and shuts on short notice. Below is a graph of the "market window" from 1994 through 2003. From early 1994 through 1996 the window was open. Activity quieted in 1997 and the window virtually closed in 1998. 1999 was generally viewed as a "selective" period for IPOs, though certain sectors such as the Internet were hot. Since the market high in January 2000, the window has been closed, but increased IPO activity in 2003 coupled with a generally strong market suggests the future for IPOs may be brighter.

As noted above, a company within a favored industry enjoys a more broadly opened window, as was the case for Internet companies in 1999 and most of 2000. This is currently true for life sciences firms. Going public while the market is strong versus missing the market by as little as several weeks can result in a postponed or withdrawn IPO and significant expenses or a lower market valuation. In addition to reviewing how companies in your industry have fared, you should also look at how the overall market is valued.

Quarterly IPOs



Source: Thomson Financial

Other sources of capital

If your company is not heavily encumbered by debt and is not searching to expand rapidly, you may be considering a long-term alternative (going public) for a short-term financing need. Other alternatives include:

- Exempt offerings and private placements of equity or debt
- Mezzanine financing
- Institutional investors
- Commercial bank loans
- Extended terms from suppliers
- Leasing
- R&D partnerships

IPO alternatives

Type	IPO Alternative	Pro	Cons
Debt	Commercial bank/lender	No sharing of profits	Dependent on sufficient net worth, income, or cash flow
Debt	Asset-based lending	No sharing of profits	Dependent on sufficient assets or cash flow – has higher borrowing costs
Other	R&D/Investment partnership or joint venture	Can result in favorably priced financing; could result in synergy and industry clout	Dependent on a viable technology or other intangibles; could result in a demanding partner
Debt/ Equity	Institutional	Can be simple – few parties involved	More sophisticated investors– may negotiate a lower price
Debt/ Equity	Leverage ESOPs	An exit strategy or financing device with certain tax preferences	Company must have adequate security for lender (assets, income, or cash flow)
Other	Selling the company	Can permit a complete and certain exit by existing shareholders	May result in lower pricing than an IPO, loss of future upside tax considerations
Convertible Debt/Equity	Venture capital	Can be simpler; added experience and reputation is brought to the company; focus is more on future potential than on current security	More sophisticated investor– may result in lower pricing for the company, plus there is an expected 5- to 7-year exit

For more information on these alternatives, please contact your local PricewaterhouseCoopers' technology professional at 1-877-PwC-TICE.

2 Current regulatory and disclosure issues

Increased scrutiny on corporate and financial reporting resulting from the corporate scandals of 2001 and 2002 means greater regulatory diligence for companies preparing for an IPO.

Sarbanes-Oxley Act of 2002

While certain provisions of the Sarbanes-Oxley Act of 2002 currently apply to private companies, including increased penalties and liabilities for certain crimes, public companies are required to be compliant with each provision of the Act. Waiting until the registration statement is being prepared and marketed to address compliance with the Act is a very daunting task. Additionally, with this type of compliance strategy, it may be difficult to find an underwriter willing to proceed with the offering. Accordingly, private companies contemplating an initial public offering should consider the following:

Internal controls – The Act requires the registrant's management (CEO and CFO) to provide certain certifications in periodic filings with the SEC regarding the company's internal controls. Additionally, on an annual basis, the external auditor is required to audit the company's internal controls over financial reporting. Accordingly, to prepare for the applicable internal controls certifications once you become a public registrant, establishing, documenting, and monitoring compliance of executing internal controls as early as possible is recommended.

Audit committee – The Act requires public companies to have independent audit committee members, including one member qualified as a financial expert. Accordingly, companies should evaluate the composition of the audit committee and seek qualified individuals.

Board of directors – The Act requires directors to be truly independent. Further, at least one board member must have a financial background – either be a CPA or have served as a CFO. One member of the board must chair the audit committee and outside directors must meet in executive session. Attracting and retaining board members has become more difficult and more expensive due to the perceived higher level of risk and shift from equity to cash compensation.

Auditor relationship – The Act prohibits a company's external auditor from providing certain non-audit services, including but not limited to, internal audit, legal, and valuation services. Additionally, permissible non-audit services must be pre-approved by the audit committee. Accordingly, companies should evaluate the existing relationship with their outside audit firm in order to avoid any possible improprieties.

Code of ethics – The Act requires public companies to establish a code of ethics, and if one is not established, the reason for not establishing one must be disclosed. Having a code of ethics and demonstrating diligence in compliance is likely to be a key element in any alleged corporate misconduct.

Loans to company executives – The Act prohibits public companies from extending or maintaining credit in the form of a personal loan to or for any director or executive officer. Accordingly, appropriate actions should be taken to ensure these types of arrangements can be extinguished prior to the initial public offering.

TIP

Be sure to give yourself enough time to recruit proper outside directors. In the post-Sarbanes-Oxley environment, you should allow four to six months for this process.

Cheap stock

In recent years the SEC has been challenging the exercise prices of stock options granted while a company is private, claiming that the exercise prices were below the market value of the stock at the time of grant. The resulting difference between the exercise price and the market value must be accounted for as a compensation expense and amortized over the vesting periods of the options. Since stock options are one of the major components of compensation for many start-up companies, this compensation expense can be significant, thus having a material effect on reported financial results. Whether this will negatively impact the IPO valuation is dependent on the current market view of this expense.

Companies preparing for an IPO need to carefully review their option pricing history. Where option prices are significantly less than the price of any convertible preferred stock sold near the dates of option grants, there will be close scrutiny by the SEC, and the closer the grant dates are to the IPO, the more intense the review.

Beneficial conversion features of preferred stock and debt

Similar to the cheap stock issues, the SEC has recently begun focusing on the conversion price embedded in convertible preferred stock and debt securities issued within one year of an IPO. Such conversion prices are compared with the IPO price by the SEC to determine whether a "beneficial conversion feature" exists (i.e., the conversion price is below the fair value of the common stock on the commitment date). If it is determined to be recorded as a beneficial conversion feature, the "in the money" portion would be a reduction to net income available to common shareholders and therefore reduce earnings per share. In the case of convertible debt securities, the "in the money" amount would be considered to be additional interest expense.

Revenue recognition

In recent years the area of revenue recognition has received a great amount of attention from the standard-setting bodies as well as the SEC. This has been due in large part to the significant revenue multiples many early-stage technology companies receive in the markets. In addition, many new and complex transactions are being created by the technology industry and the creative methods by which they transact businesses. Some of the areas that can be particularly complicated to deal with are:

- Software revenue recognition;
- Revenue arrangements with multiple deliverables;
- Barter transactions;
- Bill and hold;
- Sales to resellers;
- Consignment sales; and
- Up-front fees.

Business combinations

In recent years a number of standards have been issued regarding the accounting for business combinations. Further clarification will be forthcoming to take account of principle-based concepts such as the accounting for variable interest entities.

One aspect of business combinations, in-process research and development ("IPR&D"), has resulted in SEC staff challenging registrants that have recognized significant IPR&D charges as part of a purchase business combination.

Generally accepted accounting principles require that the purchase price allocation in a purchase business combination begin with an analysis to identify all of the tangible and intangible assets acquired. Intangible assets, such as rights to existing products, underlying technology, patents, copyrights, brand names, customer lists, marketing channels, and engineering work force, may be identified. The fair value of each asset must be estimated. The total purchase cost is allocated based on the relative fair values of the individual assets.

When determining the appropriateness of an IPR&D write-off, challenges have run to valuation methodologies and value assigned to both core technology (which is capitalized and amortized) versus IPR&D (which is expensed immediately). Underlying assumptions and data used to develop the valuations should be adequately tested or challenged by companies and their auditors. Companies should expect the SEC staff to question any significant IPR&D charges included in historical financial statements or disclosed as possible future transactions.

Consolidation issues

In response to issues noted in accounting for special purpose entities, guidance has been issued that changes the criteria to be evaluated when considering whether to consolidate an entity. The guidance sets out consolidation principles such as the risks and rewards of ownership that must be considered prior to traditional voting interest considerations.

Liability versus equity classification

Scrutiny has been placed on the classification of liabilities and equity in financial statements. This has resulted in the issuance of a standard that clarifies this classification. Certain financial instruments that were previously classified as "mezzanine" in the balance sheet may now be required to be classified as a liability.

Segmental reporting

The SEC has recently questioned registrants on the determination of business segments and adequacy of segment reporting disclosure. They found that there was often an inappropriate aggregation of multiple segments or there was an inadequate explanation of the basis for aggregating information.

3 Preparing for a successful offering

Like any other major strategy, taking your company public requires careful planning to ensure success. This requires two main tactics. First, you must prepare your management team and business units to begin acting like and functioning as a public company, both internally and externally. Second, you must identify the key players in your going-public team, from the experts you will hire to the staff members who will help prepare the registration document.

Preparation is the secret to success

The planning process can start on the day your company is incorporated or as late as 90 days before a public offering. We recommend that an orderly plan be accomplished over a one- to two-year period. This window gives your company time to think, act, and perform as a public company.

Develop a deep management team

As a company prepares for its IPO, it must expand its management capabilities. The investment community wants to be sure that management running your company is not a "one-man band." This may require adding individuals with public company experience in marketing, operations, development, and finance. Venture capital firms also desire to put a CFO in place that has been through the IPO process. The team needs to be cohesive, and share a long-term vision for the company, in order to obtain maximum financial returns and valuation.

Develop budgets and measure performance

Throughout the IPO process, underwriters and analysts will ask mature companies for projections, and will compare your historical performance to past budgets. Accordingly, you should get in the habit of preparing aggressive, but attainable, budgets and be able to articulate why variances have occurred. For the early-stage company, projections and market share are the most important measures of performance.

After you have gone public, budgets and projections will become an important tool for research analysts and market makers in your stock. Furthermore, this information and your ability to meet your own and "the street's" earnings estimates can have a significant impact on your stock's performance.

Appoint independent members to your board of directors

One of the best sources of objective advice can come from an independent or outside director. All of the major stock exchanges and markets require a registrant to have at least two independent directors, and post-Sarbanes-Oxley, one director must have previous financial experience/expertise, either a CPA or prior CFO. You should not wait until the last minute to begin your search for qualified outside board members. A potential board member who is unfamiliar with a company may be reluctant to join the board immediately prior to an IPO since a director has personal liability for information contained in or omitted from the registration statement. Providing directors' and officers' insurance (D&O) can help overcome this reluctance, although the premiums can be expensive.

Create an audit committee

Audit committees have an essential role in ensuring the integrity and transparency of corporate reporting. Investors now expect that published information has been subject to objective, board-level review. Sarbanes-Oxley specifically defines the role and composition of public company audit committees. Some of the key requirements are that audit committees:

— be composed entirely of independent directors (In order to be considered independent, the individual may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory, or other compensating fee from the company or any subsidiary of the company.);

TIP

As one of many planning considerations, think about an initial timetable that builds in time for delays. In this way, should you encounter delays, you may be able to avoid the need to include interim or updated financial statements, and thus the associated costs. Should your IPO proceed without a hitch, the worse that will happen is you will be even more flexible in your readiness for the market window.

Begin positioning your company early! Have audited financial statements and a well-documented and conservative business plan; ensure that legal "housekeeping" is thorough; cultivate relationships with the professionals who can and will help you, including underwriters, lawyers, and accountants.

If you wait until "crunch" time to have multiple-year audits, you may face two nasty surprises: first, high costs of the reconstructed financial statements; and second, figures that show the company may be performing at a level below expectations.

continued on next page

— have and disclose at least one member who is a "financial expert", defined as: 1) having experience as a principle financial or accounting officer, controller, accountant, or auditor; or 2) having experience overseeing or assessing the performance of companies with respect to the evaluation of the financial statements; or 3) other relevant experience (investment bankers, venture capitalists, commercial bankers, financial analysts);

— be directly responsible for the appointment compensation and oversight of the company's independent auditors;

— have authority to engage independent counsel and advisors as deemed necessary to carry out their duties; and

— establish procedures for dealing with concerns received from employees and others regarding accounting, internal control, or auditing matters.

For more information, please request the PricewaterhouseCoopers report on Audit Committees.

Evaluate corporate governance principles and practices

Both the NYSE and NASDAQ recently approved new corporate governance listing standards that need to be addressed in connection with an initial public offering and listing of a company's equity securities. These listing standards address matters such as board composition, structure, and process — including nomination of directors, compensation practices, and similar matters — and are responsive, in part, to the Sarbanes-Oxley Act. The standards, however, go beyond the provisions of SOA discussed previously and address such matters as the establishment of a code of business conduct and ethics for employees and directors, the establishment of an internal audit function for companies listed on the NYSE and approval of related-party transactions for companies quoted on NASDAQ. In light of these developments and given the level of interest by institutional investors and the investing public in corporate governance matters, it is important for companies to take a close look at their corporate governance principles and practices when planning the public offering process. For further information on this topic, please refer to www.pwc.com/uscorporategovernance.

Build a positive public image

A positive image can enhance the initial sales effort and maintain the public's interest in the stock in the aftermarket. Accordingly, most companies will need to enhance or create such an image with those who will buy the company's stock and with those who influence that buying decision (e.g., financial analysts, stockbrokers, the financial press, and industry publications). A positive image cannot be developed overnight; it can take months or even years to accomplish, so the earlier you get started, the better. Further, it is important that the building of the public image start well before the beginning of the "quiet period" (see "The Going-Public Process," page 34).

Creating or enhancing your company's image may require hiring a public relations firm well in advance of the public offering. This firm can assist you with getting your company's "story" out prior to the offering and with external communications and shareholder relations after you have gone public.

Other ways your company can enhance its public image include adding analysts and business press editors to your mailing lists, participating in trade shows and conferences that are attended by analysts, and publicizing key employee appointments.

Build relationships with an investment banking firm, law firm and independent auditor

These relationships will serve to establish your company's credibility. Factors to consider in selecting such firms for your IPO process are discussed in "Identifying Your Going-Public Team — The Players," page 21, and "Choosing Your Investment Banker," page 24.

Establish incentive compensation plans

Development of a long-term incentive compensation plan is critical to keeping management and employees motivated. Today, many companies establish such plans for the benefit of its management team and employees shortly after formation. As discussed in "Current Regulatory and Disclosure Issues," plans involving the granting of equity securities (including options and warrants) within one year of an IPO, may require the recording of an additional compensation charge if it is determined that these securities were issued at below fair market value at the date of grant.

Many investment bankers like to see preexisting option plans in place with options issued to the management team. If much of an individual's wealth is associated with the growth of the company and the value of the unexercised options, the underwriter will see a long-term commitment, and this may help the valuation of your company.

Please see "Compensation Planning and Design," page 59, for more detail on this subject.

Loans to executives

Section 402 of the Sarbanes-Oxley Act of 2002 prohibits publicly-traded companies from providing certain personal loans to directors and executive officers. Among the reasons identified were concerns over the use of company funds to provide personal financing to insiders. As a result, companies should work with appropriate legal counsel to determine which loan arrangements are considered prohibited and take appropriate corrective actions prior to the public offering.

TIP con't.

Another critical planning point is your equity-oriented incentive plans, which should be in place a minimum of one year — and preferably longer — before the IPO. Too often the question of how to compensate key executives arises late. It simply won't do to issue a significant amount of stock or options with an exercise price of $1 a share when an IPO is contemplated with a much higher per-share price in the near term. This could cause additional compensation to be recorded. On the other hand, if there are clear and distinct reasons for the company's valuation to increase significantly, these should be thoroughly documented, ideally through an independent and timely appraisal.

Have your financial statements audited and resolve potential disclosure and accounting issues

A company that wants to go public needs to have audited financial information. It is easier and more cost efficient to perform audits of financial statements in the normal course of business, rather than shortly before going public. Further, the existence of audited financial statements provides increased credibility to your company. Another consideration is whether you've grown the business through acquisitions. If so, separate audited financial statements of businesses acquired may be required at the time of the offering. Obtaining audited financial statements of these companies after the fact can be a difficult and costly task and could potentially delay your IPO timetable.

As your company gains financial sophistication, it should also begin preparing quarterly financial statements. More and more offering documents display the prior four, eight, or twelve quarters in order to reflect growth and trends. Having them prepared timely can add to an investment banker's evaluation of your company.

As noted in "Securities Regulations" (Appendix A) and "Current Regulatory and Disclosure Issues," the company's financial statements included in your IPO registration statement will have to conform to positions and practices prescribed by the SEC staff which may be different than financial statements previously prepared.

Draft management's discussion and analysis (MD&A)

A stumbling block that many companies face is their inability to describe why the company's performance was what it was. A registration statement and all future financial statement filings with the SEC will require inclusion of Management's Discussion and Analysis or MD&A related to those financial statements. This is a quantitative and qualitative discussion of your company's performance. You will need to describe in depth such items as changes in sales volumes and cost structures, liquidity and capital resources, sources and uses of cash flows, vendor relationships, employee compensation, unusual nonrecurring charges, significant environmental exposures, and other risks and uncertainties.

As you complete your year-end and quarterly financial statements, you should take time to write your MD&A. It is very difficult to remember why insurance costs went up or when a marketing campaign commenced three years after the fact. The practice of writing quality, comprehensive MD&As will expedite your registration process and will be a major step toward operating like a public company.

Identifying your going-public team — the players

You need expert direction to stage a successful IPO. It is a big production with an imposing cast of characters. Your company will audition and pick some of these professionals, but one of the starring roles is assigned to you. The SEC is a stock character who has long since memorized the lines and knows how to play the role.

The Securities and Exchange Commission (SEC)

The SEC is charged with ensuring a fair and level playing field for public companies and their investors. It has the authority to pursue civil and criminal prosecution against those who breach established procedures.

Liability may arise from material misstatements or omissions in a registration statement. If the SEC finds mistakes during the registration process, it can delay your IPO. If it finds mistakes or omissions after your company goes public, your company may soon have a thorough — and unpleasant — understanding of what legal liability is.

It is your duty to potential shareholders to constantly monitor the drafting of the registration statement. Make sure that you completely understand all of its components and the assumptions behind those components. The outside professionals you hire to execute your IPO are experienced business advisors. They help you make the final decisions, not make them for you.

The SEC's Division of Corporation Finance reviews the registration statement and, ultimately, allows or denies an issue to "go effective,' that is, to sell shares. Registrants generally are assigned to the SEC's Division of Corporation Finance's review branches on the basis of standard industrial classification (SIC) codes. Teams of government attorneys and accountants — and in some cases industry specialists or engineers — review each filing. The chain of review leads up to the director of the division and the issuance of a "comment letter," as more fully described in "The Going-Public Process."

The SEC concerns itself with the thoroughness and the clarity of the registration statement and the prospectus to ensure that these documents adequately inform potential investors. Keep in mind that the SEC only regulates the vehicle used to offer a security; it evaluates neither the company nor the quality of the security.

Company personnel

The level of your company's participation in the process of preparing the registration document frequently depends on the expertise of the company's personnel, although typically your outside counsel will play a large part in the drafting process. In any case, company personnel will have to provide the necessary information with which to prepare the document and be actively involved in all aspects of the registration process.

TIP

Even with an experienced team of advisors, make sure your company takes an active role in controlling the progress of the IPO. Remember, of all the parties involved the company has the most at stake.

You should not underestimate the level of commitment a public offering will require of you and your staff. The process requires a great deal of your attention and will likely distract you from the day-to-day operations of your business. It is important that you recognize that this is common in an IPO and, in some instances, may necessitate hiring additional staff. As mentioned on numerous occasions in this guide, your team's commitment to the offering will be the difference between a successful IPO and a failed attempt.

Your company's securities counsel

As with any selection of individuals to provide professional services, there must be the right chemistry between the management team and your securities counsel. Your attorney will become the quarterback of your registration process.

Your counsel must be professionally competent and have the ability to put into plain English (see "Current Regulatory and Disclosure Issues," page 12, for more information) technically challenging concepts and descriptions of complicated transactions. He or she must have the ability to evaluate large amounts of information and turn around documents quickly. It is imperative that you find an attorney who is experienced with the IPO process as well as your industry and who you are comfortable and confident with will protect your interests when dealing with the underwriters and the SEC staff.

The investment banker

A critical part of planning your public offering is the selection of an investment banker. This is a courting process that should start early and will allow each side to develop a level of comfort and knowledge to create a positive team environment. Please see "Choosing Your Investment Banker," page 24, for a detailed discussion of what an underwriter does and how to choose and work with them.

The underwriter's counsel

Also involved in the IPO process are the underwriter's counsel who are generally responsible for drafting the underwriting agreement. They also review the entire registration statement and any related agreements and contracts that are filed as exhibits thereto. Their principal objective in reviewing the registration statement is to ascertain on behalf of the underwriter that the registration statement is complete and not misleading. In addition, underwriter's counsel usually prepares the "blue sky" filing which is necessary to have the registration approved by state regulators. Another task performed by the underwriter's counsel is the negotiation of the content of the "comfort" letter(s). See "The Going-Public Process," page 34, for more detail.

Independent auditors

Your independent auditors will play a key role in the going-public process. Drawing on deep experience dealing with the Staff of the Securities and Exchange Commission and the registration process, your accounting firm should be uniquely positioned to play a lead role throughout the process as strategic and technical advisors. They will not only be responsible for auditing the various financial statements that will be included in the registration statement, but also will be responsible for reading, in depth, the textual portion of the registration statement and related financial information. Your auditors will issue a comfort

letter to the underwriters, organize and participate in any pre-filing conferences with the SEC staff that involve the financial statements or related disclosures, and assist in the resolution of comments raised by the SEC staff in its review of the financial information included in the registration statement.

The importance of engaging qualified independent auditors long before the IPO cannot be overstated, particularly if your company has never had audits of its financial statements performed. The first audit of many young and expanding companies often discloses accounting and financial reporting problems that must be resolved before the registration statement can be filed.

Typically, large accounting firms are structured as full-service professional firms, offering services in various lines of business. Your independent auditors, as well as individuals from these other lines of business, can play a valuable role as advisors in a variety of areas before, during, and after the going-public process. Some of these include evaluating whether going public is the best alternative for your company, evaluating incentive compensation plans, accounting systems' needs and capabilities, reviewing terms and conditions of acquisitions, and tax planning.

In selecting an accounting firm, make certain that the firm is knowledgeable of your industry and its issues, experienced in SEC reporting matters and the IPO process, is capable of handling all that will be required of it during the registration process and thereafter, and is acceptable to the underwriters.

The financial printer

Another important, but sometimes overlooked, factor contributing to a successful IPO is the role played by the financial printer. The printer is responsible for printing the registration statement and prospectuses according to the format and presentation guidelines specified by the SEC. The major financial printers can also "EDGARize" your document and make the required filing with the SEC via EDGAR. (With respect to EDGAR, it is important that you file Form ID with the SEC well in advance of the offering to receive your access and identification codes.) Because this is specialized printing involving rapid turnaround, only a few printers can adequately handle it. Your underwriters, attorneys, and accountants will be able to recommend qualified financial printers.

Other professional advisors

A public relations firm experienced in SEC registrations can help guide you through the restrictions of the "quiet period" and make the most of the opportunities that do exist, help prepare materials for analyst presentations, and coach management with presentation skills. In addition, management teams are hiring speech consultants to help them prepare for the road show.

A stock transfer agent will need to be appointed to provide those administrative and operational services associated with trading stock. The transfer agent issues, cancels, and transfers stock certificates, pays dividends, and handles other corporate actions, as well as distributes shareholder reports.

Another administrative task you must consider is selection of a firm to design and print the company's stock certificates.

4 Choosing your investment banker

As one of the key players on your going-public team, selecting the right underwriter is one of the most important decisions you will make. Ensure it is the right one by doing your homework, taking the time to develop a strong and comfortable relationship, and agreeing on roles and responsibilities. These people will represent your company in front of potential investors, analysts, and regulators. They should be as comfortable with and positive about your company as you are.

Selecting the right underwriter

Your initial contacts with the investment banking firm will likely be with representatives whose responsibility is to bring in new clients and new transactions. Make sure that you also meet and evaluate the research analyst on your account and the appropriate people on the trading desk to assure yourself that the managing underwriting firm is committed to your offering.

You have put together a team of experts with the skills and talents to advise you in your IPO. But it's the underwriter who actually puts it all together for you. A company's dependence upon an underwriter for a successful IPO is, therefore, very great. That is why it is of unique and critical importance that you are familiar with the IPO process before you begin, and that you know how to select the right underwriter for your company. You should also understand the basics of your underwriting agreement, as well as with valuation and pricing issues, and the after-market support you can expect from the underwriter you choose.

The underwriter in brief

You can go to market without an underwriter, but the process is so complex and the know-how so specialized that it is rarely done. The complicated market issues that are arcane to most people are the stock-in-trade of underwriters, and it is in the best interest of your company's offering to take advantage of their expertise. The "value added" by your underwriter should be the assurance that your IPO will be properly managed and successfully marketed and supported, both before and after going public.

Your principal, or "managing" underwriter will work with you to develop the registration statement, coordinate the road show, underwrite certain risks, and form a syndicate. This syndicate is composed of an underwriting group — which bears the risk of the underwriting — and the selling group. The selling group solicits interest from its retail and institutional clients, sells your stock once your IPO goes effective, and provides after-market support. The typical allocation of the underwriter's discount is 20 percent for the managing underwriter, 20 percent for the underwriting group, and 60 percent for the selling group. The share allotment each underwriter is committed to buy will be stipulated in the prospectus.

Good managing underwriters and investment bankers have a highly developed sense of what sells (or doesn't sell) and for how much. They also have an instinct for timing an issue, and they are able to anticipate pitfalls and calculate risks. Underwriters and investment bankers contribute other skills and support, including:

— Experience in marketing, structuring the deal, and facilitating syndications with co-underwriters and brokers to create support for the stock after it is issued;

— Knowledge of market conditions and various types of investors;

— Experience in pricing stock so that it will be attractive to the company but also reap a reasonable return for the investor;

— The ability to help client companies with future offerings; and

— A research department with the scope to enable it to analyze the client company, its competitors, the market, and the economy as a whole.

Generally speaking, underwriters come in three sizes: “major bracket” or “wire-house” firms with well-known names; a middle tier comprising mostly regional firms; and local firms. Not surprisingly, the size and scope of your company and of your offering will, in part, determine the size of the underwriter you enlist for your IPO.

Companies anticipating an IPO of $50 million or more and possessing the characteristics outlined in “Is Going Public Right for Your Company?” can readily enlist major-bracket underwriters. Regional firms often look for the same types of offerings, only they must be in excess of $20 million. Local firms are often associated with smaller, higher-risk, or specialty companies.

A good working relationship with your underwriter is key, regardless of the size of the firm you select. You must have the trust in and confidence of your underwriter to provide all the information you will need to execute your IPO successfully.

Of course, the professional relationship between you and your underwriter is mutually beneficial. Your underwriter earns money from your offering in a variety of ways. These include:

— The discount or commission. This averages around seven percent but could be up to ten percent for more difficult or smaller offerings and down to five percent for larger or simpler offerings in a competitive market.

— The right to underwrite future offerings of the company’s securities.

— Non-accountable expense allowance. This standard practice allows underwriters to bill you an amount that may not exceed three percent of gross proceeds without itemizing or otherwise detailing reimbursable expenses.

— Other compensation, such as warrants to purchase stock.

— Overallotments, see After-market support (page 31).

While these items may seem to allow quite a few charges by your underwriter, maximum underwriters’ compensation — both direct and indirect — is regulated and reviewed for fairness by the NASD before the offering may proceed. Blue Sky laws also require a review of underwriters’ compensation by state examiners. Closely associated with the underwriter is the underwriter’s attorney, who ensures that the underwriter has completed their extensive “due diligence” in the issue. This attorney also will be very involved with the drafting sessions and will review

the prospectus for compliance with SEC regulations. They will normally handle the individual state Blue Sky qualifications of the issue and work closely with the underwriter in drafting the underwriting agreement and the various underwriters/syndicate selling agreements as well as reviewing all important agreements into which the company has entered. Last — but not least — the underwriter's attorney will review all the corporate documents — such as minutes, bylaws, and articles of incorporation — to ensure registration statement disclosures are accurate.

You may be shaking your head right about now, but don't! These professionals are involved with your IPO to ensure that you conform to SEC rules and regulations and that your IPO worries are minimized.

The selection process

Selecting the right underwriter for your company is not simple. You may, in fact, be determining the success of your offering then and there, so take your time and be objective. In general, the size of the underwriting firm will mirror the size of the company's potential offering. Typically, a company will speak to several underwriters first, and this process is really a two-way street. Exercise care in these early interviews to assure the relationship remains balanced. This will prove beneficial, both before and after going public.

Ideally, begin building relationships at least one or two years in advance of your IPO. This may also allow the firm to help raise capital as a "bridge to an IPO," should the need arise.

"Courtship"

An investment banking or underwriter relationship is a lot like a romance. It is often built on well-intended words, can get very intense and, for various reasons, fall apart. When it comes to your IPO, though, you must be in it for the long haul, so keep your eyes wide open.

Before you become "engaged" with a letter of intent, make sure you have done your homework. Although a letter of intent does not necessarily bind either party, it can prevent you from dealing with other underwriters for a stipulated period of time. Thus, do not enter into such a letter until you are confident of your choice.

After you have identified two or three underwriters who are interested in your company, you must then evaluate each, in part, by answering some important questions.

— What is the firm's experience and track record with your company's industry? Financial printers (e.g., Bowne, R.R. Donnelly, and Merrill Corporation) and independent research firms (e.g., Thomson Financial, IPOMonitor.com, Hoovers.com) provide terrific data on underwriters — including number of deals overall and by sector, percentage increase in value, compensation, etc.

— Will the underwriter still provide quality after-market support in an active market?

TIP

In April 2003, the SEC announced a global settlement of enforcement actions against several Wall Street firms relating to an investigation of research analyst conflicts of interest. The terms of the settlement included several structural reforms intended to separate the firms' research and investment banking activities, including an agreement that research analysts will be prohibited from participating in efforts to solicit investment banking business, and the creation and enforcement of firewalls between research and investment banking to prohibit improper communications between the two. Given the limits on interaction between the research analyst and investment bankers, the terms of global settlement will likely impact your approach to evaluating and eventually cultivating a relationship with your investment banker and will result in less involvement from the research analyst in the IPO process.

TIP

Sometimes the best information you can obtain on a potential underwriter is through informal processes. Ask for a list of past IPOs that the underwriter has served in a similar capacity to your planned IPO. From this overall listing, pick several recent and older IPOs of a size similar to your company and call for a reference. Ask them some — if not all — of the questions we've already suggested, as well as these: Would you use the underwriter again and, if so, is there anything you'd change? How did the pricing process go? Did the underwriter sell the overallotment? What surprises were there? How has the after-market support and research been?

— Who will lead the underwriting team? Can he or she command the full resources of the firm?

— Can the firm provide complete syndication, after-market support, and other services? Who will price the IPO and is the personal chemistry good between you?

— Is the size of the planned offering or long-term financing attractive or just within the underwriter's threshold?

— Is the underwriter primarily a retail or institutional firm?

— What is the firm's backlog of other equity business over the timeframe of your offering?

— What are the firm's national or regional distribution capabilities and how does this compare to your company's needs?

— How strong and responsive is the research department and its reputation for your industry?

— What happens if the market heats up and the underwriter becomes uninterested in your offering or wishes to increase the offering size?

— What kind of unique terms, if any, will the underwriter require?

You can answer some of these questions by talking to the underwriting team, both the team leader and the members of the team of whom you may see more as your work progresses. You will find other answers by talking to companies with whom the underwriter has worked in the past. You should make a few calls because it is important to know whom your company is about to "marry" before you say "I do." Ultimately, you must take the time to form your own opinion and trust your instincts. If the relationship won't work on a personal level, the hard work that must be done will be made all the more difficult.

Certain indicators that may be offered as "facts" aren't necessarily so. The proposed per-share offering price is one such area, and you should exercise caution when evaluating underwriters on this basis. As attractive as the most favorable price may be, the reality is that the final offering price frequently changes — most often downwards.

The impact of retail versus institutional investors

An underwriter with a balanced mix of retail and institutional clients can provide shareholder diversity to your company. Institutional investors are usually viewed as longer-term investors, but if they decide to sell, they can cause a considerable swing in the price of your stock. As a result, institutions often wish to have sufficient public float (i.e., more than a million shares held by nonaffiliated shareholders) to avoid excessive volatility upon selling their position. Thus, larger offerings tend to attract a greater mix of institutional investors. On the other hand, while retail investors can be a little more emotional in their trading, their individual decisions do not usually affect your company's stock unless a significant number act within the same time frame.

The "letter of intent"

This is the first of several documents into which you will enter with your underwriter. As noted, though it is a signed document, it is not binding beyond the narrow expense provisions it delineates. The second document, which is binding, is the underwriting agreement. Under normal circumstances, it is not signed until within 24 hours of the expected effective date of the registration statement. By this time, the underwriter has received commitments or indications that are commonly well in excess of the offering size.

Between the time you sign the letter of intent and the underwriting agreement, your company will incur substantial expenses with no assurance that the offering will take place. This is not an idle observation. Stories about IPOs reaching the eleventh hour only to be withdrawn or delayed because market conditions have changed or the underwriter has reconsidered do exist.

The underwriting agreement

Underwriting agreements come in two basic types: "firm commitment" and "best efforts."

Under a firm-commitment agreement, the underwriters pledge to buy all of the stock offered in the IPO and resell it to the public. This arrangement offers the company the most security because the owners know they will receive the full sales price of the issue. However, until the underwriter and the company establish the final pricing and execute the underwriting agreement, the only commitment on the line is the underwriter's reputation.

In contrast, under a best-efforts commitment, the underwriter, using his best efforts to sell the stock, is under no obligation to purchase the stock should part of the issue remain unsold. An underwriter who considers the issue to be risky may choose this type of agreement to shift the risk to the company.

There are variations on these two basic agreements. An "all-or-none" commitment is a modification of the "best-efforts" agreement: All of the stock must be sold by the underwriter or the entire issue is canceled (at considerable cost to the company). In a partial "all-or-none" agreement, the underwriter requires sale of a specified portion of the issue (typically two-thirds) for the "best efforts" to remain in effect on the remainder of the issue.

TIP

Most IPOs are firm-commitment underwritings. If the underwriter your company is evaluating is only willing to proceed with a "best-efforts" underwriting, you may wish to reevaluate the alternatives described in Chapter 1, as this may be an indication your company is not ready to go public.

As part of the underwriting agreement, it is common for an underwriter to request a "lock-up" of the insiders' stock for a period of several months (typically six months) after an IPO. Even though sales of such shares may be somewhat limited due to other restrictions (i.e., Rule 144), it is the underwriter's goal to maintain a strong after-market by avoiding insider sales or "bailouts."

TIP

Stock splits and reverse stock splits are commonly used to adjust the expected IPO price to be between $10 and $20 per share. Advance coordination with the underwriters is key in ensuring such splits are needed only once. This will avoid unnecessary expenses and confusion.

Valuation and pricing issues

You may be most concerned with two underwriting functions in particular: valuing your company and setting a stock price. Valuation and pricing issues can involve a significant amount of time for both the underwriter and management and can have multimillion-dollar implications. Although there is no standard formula, certain factors are always included in the valuation process. First, the underwriter must consider the condition of the market as a whole at the time the IPO is undertaken. Second, the final price will reflect the demand generated as a result of the "road show," the period when your company and underwriter will try to generate interest in the offering.

Prices of other successful and similar offerings will also come into play, as will your company's projected earnings and cash flow at the time of the offering. Price/earnings ratios and return on sales of other companies in your industry may be used to extrapolate a price for your stock.

Finally, the underwriter will consider a host of other, more subjective factors: expected growth; recent prices paid by sophisticated buyers in private transactions; inherent risks of the business; the company's stability; and the after-market trading objectives.

Taking all this into account, the underwriter will most likely choose a slightly lower price than the estimate. This is to guard against a weak after-market and to give buyers an incentive. Major-bracket underwriters generally prefer a price range of $10 to $20 per share. Underpricing or overpricing occurs when the first trades of the newly issued stock trade above or below the offer price. Underpricing tends to be more persistent than overpricing, according to certain studies. This underpricing, if it is modest, has some arguable merits, i.e., after-market support, rewarding investors for taking a risk on the IPO, and — provided the market price holds or continues to increase — enhancing the possibility of a successful secondary offering.

There are a variety of theories as to why underpricing exists. One theory suggests that underpricing creates a high enough return so that even lower quality issues can be fully sold; another considers the phenomenon a reflection of the underwriter's incentive to avoid legal liability and reputational damage.

Perception is part of what makes pricing tricky. Selling five million shares of stock at $5 a share or two million shares at $12.50 will raise the same amount of money — $25 million — but a lower per-share price can negatively influence an investor's sense of the offering's quality and an underwriter's desire to participate in the offering.

You must realize and keep in mind throughout the pricing process that your underwriters are faced with a tricky job. They must balance the pricing in such a way that neither the company nor the investor comes away totally thrilled — since one party's pleasure comes at the expense of the other party. Underwriters like to say they will attempt to maximize the offering price to the company and provide a reasonable return to investors.

In any case, it is likely that you won't know the actual pricing of your offering until the day before it becomes effective and the underwriter's agreement is signed. Until that point, the underwriter is not obligated to conduct the offering at any previously mentioned price or price range. Even though underwriters set the price at which the stock is finally offered, they do not control the price. Your underwriter cannot make a $10 stock sell and continue to sell in the after-market at $15; the market is too sophisticated to allow that kind of overvaluation.

The final question involves just how much of your company you will sell. This is largely dependent on your company's needs for the proceeds, market conditions, and the company's market valuation. As a general practice, however, companies sell 15 percent to 40 percent of the post-IPO outstanding shares. This tends to be influenced by a variety of factors, including selling enough shares to justify the expenses and interest the underwriter, while not selling too many shares, as this could cause excessive dilution, be perceived as a bailout, or create problems with state Blue Sky laws.

Timing, as mentioned earlier, is of the essence in your IPO. Good underwriters are masters of timing: they are experienced in avoiding seasonally slow periods and, more importantly, finding a "window" in the market, the most advantageous time to make a successful offering at the best price. When this "window" opens, it generally places enormous time pressure on everybody. At this point, the primary concern of your entire team should be to exercise extreme care and due diligence to ensure that such pressure does not result in failure to make proper disclosure.

After-market support

After all that work has been done and your IPO has succeeded, there's still more work for your underwriter to do. Competent after-market support entails providing research data on your company and its competitors to the financial community as well as financial and business advice to you. A quality road show should leave an unsatisfied demand level that will further help the after-market support and performance of your company's stock.

The quality of the firm you select and its ability to take large positions in your stock is important to supporting the after-market value of your shares. The underwriter's after-market support may come into play shortly after the IPO, should speculators jump on the issue hoping to "flip" it or turn it around and sell their stock quickly at a profit. If too many people sell their shares and flood the market, the stock's price may fall below the offering price. If this happens, the underwriter must have the financial resources to buy the stock and, if necessary, hold it until the stock's price rises.

SEC rules permit underwriters to offer and sell to the public more shares than they are contractually obliged to buy (an "overallotment"). The underwriter may take advantage of this provision to stimulate demand in the after-market or to help maintain an orderly market for a "hot" stock. To stimulate demand, the underwriter sells shares directly to investors. To cover this short position, the underwriter will enter a bid to buy the stock in the after-market, which helps support the price.

TIP

Companies often develop projections for strict use with the underwriter in valuation discussions. Avoid sharing such projections with other parties, as this can easily be incriminating evidence if results fall short of your projections. Consult with your accountant and attorney on the use of any projections during the IPO process.

To help maintain an orderly market, the underwriter buys from the issuer a set number of additional shares (typically up to 15 percent of the offering) at the offering price, solely for covering overallotments. The “Green Shoe Option” — so-called because the first instance involved the Green Shoe Company — must be exercised within 30 days of the effective date. Thus, this additional supply of stock can help unsatisfied demand from causing a “run up” of the stock.

New models – online IPOs

E-syndicate houses

New investment banking houses, leveraging the Internet and catering to the needs of individual investors, emerged in the mid-1990s. Most of the original players have since been acquired or merged with other well-known financial firms. As of 2004, the most widely known e-syndicate houses are CSFB Direct, E*Trade, and Charles Schwab. These firms disseminate new offering information online to their clients and networks of online brokerage firms. The typical investment banking relationship with the issuing company still involves a lead underwriter as outlined above, but an e-syndicate house participates as part of the syndicate or co-manager of the offering. As noted by Sanford Miller of 3i, “e-syndicates are really an evolution that reflects the reality that online information is convenient and speedy. The syndicates are only as strong as their underlying retail networks.”

Dutch auctions

This widely successful procedure for issuing Treasury Notes was adopted by W. R. Hambrecht in 1999 in what is termed the “OpenIPO” method. This method is designed to provide more efficient pricing and allocation directly to the highest bidders. All successful bidders pay the same price per share. But as Robert Tomkinson, a Principal at Athena Technology Ventures, notes, “Unfortunately, OpenIPO arrived on the scene just as the Internet bubble was about to burst and thus has not had the opportunity to establish its credibility.” In fact, of the nine OpenIPOs led by W.R. Hambrecht, as of March 2004 six are significantly under water. Tomkinson adds, “One concern has been adverse selection: the worry that only companies passed over by Wall Street heavyweights like Morgan Stanley or Goldman Sachs would be willing to risk a novel approach such as OpenIPO, for all its theoretical merits.” Sanford Miller, a general partner at 3i, shares Robert’s view and adds, “Intellectually the concept is quite appealing. The reality is that traditional IPOs work very well and are an effective way to market a new company. For secondary offerings of reasonably well-known companies the Dutch Auction format can be an effective means of offering.” Whether this approach will succeed in the long term is yet to be seen.

Regardless of approach, Peter Ziebelman, a general partner at Palo Alto Venture Partners, offers this sage advice, “The advent of the new models for IPOs (whether they are E-Syndicates or OpenIPOs) may help the market redefine what is commonly thought of as a ‘successful IPO’. But, a successful IPO should not be measured on the price jump on its first day or even first month of trading.

A successful IPO is a company that has prepared itself for the reporting and competitive challenges as they disclose more information about themselves. A successful IPO will continue to build value for its shareholders that will show up as an increase in the share price year after year. The successful company will use the public spotlight to amplify its competitive advantages and its ability to satisfy shareholders, employees, and customers."

How PricewaterhouseCoopers can help

The professionals at PricewaterhouseCoopers can help you choose the right underwriter and provide advice in other underwriting matters. Specifically, we can:

— introduce your company to qualified underwriters;

— assist your company's underwriter selection process;

— participate in the due diligence process to help reduce potential legal liabilities; and

— review an underwriter's initial valuation (pricing) work to spot any errors or overly conservative assumptions.

5 The going-public process

Two years in advance of going public, you should do your best to operate as if you are already a public company — doing this will teach you invaluable lessons in earnings management

Typical 100 day timeline

Before effective date

	2 Years	4-5 Months	3 Months (100 Days)	20 Days	1-10 Days	Offering Day
Company	Act like a public company	Select the team; Hold organizational "all hands" meeting	"Quiet period" begins; Hold "all hands" meeting; Execute letter of intent: Select printer & transfer agent; "Clean up" financial statements and ensure their compliance with Regulation S-X	"Cooling off" period begins; Executives perform "road show"		Execute underwriting agreement; Issue press release
Company Counsel			Perform "housekeeping" of company records; Draft S-1; File w/the SEC; File NASDAQ listing application	Clear SEC comments	Pricing amendment filed; Acceleration requested; File final registration statement	
Independent Accountant			Complete audit of annual and review of interim financial statements; Review registration statement	Audit/review updated financial statements, if necessary; Respond to SEC comment letter	Deliver draft "comfort letter"	Deliver final "comfort letter"
Investment Banker			Assess market; Make presentation to board; Continue due diligence	Distribute "red herring"; Orchestrate "road show"; Solicit expressions of interest	Form syndicate; Place "tomb-stone ad"	Execute underwriting agreement; Run tomb-stone ad
Investment Banker's Counsel			Begin due diligence; Prepare NASD Regulation filing; Undertake "Blue Sky" filings	Clear NASD Regulation comments	Continue due diligence	
Financial Printer				Print preliminary registration statement/ prospectus (red herring); Produce SEC & NASD Regulation "filing packages"		Print final registration statement/ prospectus
SEC	Conference regarding "problems", if necessary	Review preliminary registration statement; Issue comment letter				Declare offering effective
NASD Regulation			Request prefiling advice, if necessary	Review preliminary registration statement; Issue comment letter	Resolve comments	Declare no objections

(See Appendix B — Detailed Going-Public Timetable for more information)

After effective date

	5-7 Days	(0-30 Days (optional)
Company	Provide certificates; Collect proceeds	Provide additional certificates; Collect additional proceeds
Company Counsel	Deliver documents/opinions	Update closing documents
Independent Accountant	Deliver “bring down comfort letter”	Second “bring down comfort letter”
Investment Banker	Provide net proceeds	Exercise overallotment option; Make determination about issuing research report
Investment Banker Counsel	Assist in closing	Assist in second closing

(See Appendix B — Detailed Going Public Timetable for more information)

Once a preliminary understanding with your underwriters has been reached, the IPO process begins in full force and a “quiet period” begins during which your company is subject to SEC guidelines regarding publication of information outside the prospectus. The opportunity to enhance awareness of your company, its name, products, and geographic markets will be limited, since any publicity that creates a favorable attitude toward your company’s securities could be considered illegal. However, the continuation of established, normal advertising and publicizing of information is acceptable.

This phase of the offering should start with a sense of urgency, because the clock is ticking. You’ll need to juggle four tasks in parallel timelines and keep your business running as usual. These four tasks are:

— The preparation of the preliminary prospectus;

— The investigation of your affairs for underwriter due diligence;

— The monitoring of market conditions for pricing purposes; and

— The preparation of marketing materials for the road show.

As previously mentioned, you can generally expect it to take anywhere from three to five months from the time your company decides to go public until the time it receives the proceeds from an offering. The actual length of this period depends on, among other things, the readiness of your company to go public, the availability of the information that must be disclosed in the registration statement, and market conditions.

The principal steps in an IPO process are listed below.

DAYS 1-60

Holding the “all hands” meeting

The first step in the IPO process is arranging an “all hands” meeting. This meeting should be attended by all members of the registration team — company management, independent auditors, underwriters, and your company’s — attorneys — as well as the underwriters’ attorneys. The purpose of this initial organizational meeting is to discuss the nature of the offering and the appropriate SEC registration form, coordinate responsibilities for sections of the registration statement, establish a timetable for the anticipated filing date, and share information regarding the working group’s availability.

Throughout the IPO process, additional “all hands” meetings will take place to discuss any problems, to review drafts of the registration statement, and to determine whether the registration process is on schedule.

Registration statement form

The determination of the SEC form to be used for registration purposes is a legal determination and is to be made by your company in consultation with counsel and the underwriter.

Form S-1 is the basic registration form for venture backed company IPOs. Form SB-2 is the basic form used for smaller business filers — less than $25 million in revenue and IPO proceeds. The financial statement requirements of Form SB-2 are less stringent than those of Form S-1.

TIP

As excited as you may be about your IPO, do not promote during the quiet period. Allow the quiet period to be just that — quiet. Loud noises attract attention you might not want, particularly from the SEC. Keep confidential company information confidential. Spreading news about the company to friends, family, and even in casual conversation to the person next to you on an airplane, can be a real temptation — and can spell real trouble.

Of course, you are not the only source of information. Keep in mind as well that the press, which is by definition independent, will time its articles according to its interests, which may not be in the best interests of your offering. Excessive attention during the quiet period can only hurt, and managing press interest shouldn’t be left to chance. Work with your experienced public relations firm and SEC counsel to properly maintain the quiet period.

Registration requirements

	Form S-1[1]	Form SB-2
Income statement	3 years	2 years
Balance sheet	2 years	1 year
Statement of cash flows	3 years	2 years
Earnings per share	3 years (corresponding to income statement) and 5 years for selected financial data section	2 years (corresponding to income statement only)
Financial statement schedules	3 years	Not required
Management's discussion and analysis	Required	In less detail than S-1[2]
Selected financial data	Required	Not Required
Separate financial statements for significant acquisitions	Required	Required
Pro forma financial information[3]	Required	Required

(1) The requirements are for the periods indicated or from inception of the business, if later.

(2) A Plan of Operations describing the company's business plan of operation for the next 12 months may be used in lieu of MD&A if the issuer has not had revenues in each of the last two years. The plan of operation should discuss the company's ability to satisfy its cash requirements, a summary of product research and development, expected purchases or sales of plant and equipment, and any expected significant changes in the number of employees.

(3) Additional information on pro forma financial information requirements may be found in the Financial Information section under pro forma financial information, page 41.

Preparing the registration statement

The preparation and filing of the registration statement is a relatively complicated, time-consuming, technical process requiring substantial planning and coordination in order to provide the information specified by the SEC form being used and to comply with the applicable SEC rules in the most efficient manner possible. It involves a great deal of effort by your management team, lawyers, and accountants to position your company as positively as possible, while also disclosing any negative risk factors.

It is during the preparation process that your scheduled timetable for going public can fall asunder, causing a delay in the anticipated filing date. It is therefore imperative that the entire team be thoroughly familiar with the registration statement requirements, be cognizant of the deadlines set, periodically assess the status of sections of the registration statement, and ensure that reviews of the sections are timely.

The registration statement (Form S-1) consists of two principal parts. Part I contains the essential facts regarding the business operations, financial condition, and management of the company that are required to be included in the prospectus, including the company's financial statements. Part II represents additional information that is not required to be included in the prospectus.

The Form S-1 filing

Information that is required by the Form S-1 includes the following:

Part I – Information required in the prospectus

Prospectus summary. This appears at the beginning of the prospectus and is basically a short summary describing the company, its business, the type of securities being offered, the amount of estimated proceeds, the intended use of the proceeds, and may also include certain summary financial information. This section also includes the complete mailing address and the telephone number of the company's principal executive offices. Although not required, companies are including their Internet Web site address in this section.

Risks associated with the business. Any factors that make your offering speculative or risky must be disclosed. These factors may include those that appear in the following list:

- Recent adverse developments or operating losses;
- The need for additional financing;
- The dilution to public investors;
- Industry trends or business seasonality;
- The existence of significant competition;
- The company's dependence on a few customers, suppliers, or key members of management;
- Information regarding significant contracts or licenses;
- Impact of current or proposed legislation (e.g., communications, health care); and
- Technological changes.

Use of proceeds. Your company must disclose and discuss the planned use of the proceeds from the offering. This section of the registration statement should be carefully drafted because the SEC requires reports on the actual disposition of the proceeds after the offering is completed. Because the actual use of proceeds may change between the filing date and the effective date as the company's plans change, it may be necessary to revise this section of the registration statement on the effective date. Typical uses might include debt reduction, acquisitions, S corporation distributions, research and development expenditures, and marketing expenses.

TIP

As distracting as your IPO may be, keep a keen eye on your business! IPOs are easily so absorbing that you can lose track of your business. Just be cognizant of this "distraction potential" and plan for it to ensure your business does not come out of the IPO process weaker than going in. For example, it may be useful to appoint an IPO team captain to manage the process.

Dividend policy and restrictions. Your company must disclose its current dividend policy, any anticipated changes to that policy, and any restrictions on the company's ability to pay dividends. For example, it is not uncommon for many new public companies not to pay dividends, but rather retain earnings to finance operations and the company's expansion. Restrictions might be based on debt, contractual agreements, or the regulatory environment in which your company operates.

Capitalization. Although not a requirement of Regulation S-K, the capital structure of a company both prior to the offering and after all securities offered are sold, is usually presented in a tabular format.

Dilution. When a disparity exists between the IPO price and the net book value per share of tangible assets, dilution results. The effects of any material dilution to prospective investors must be disclosed; this is usually presented in a dilution table.

Underwriting and distribution of securities. Information must be provided about the price of the securities being offered, the members of the underwriting syndicate, the type of underwriting, and any relationship between your company and any of the underwriters.

Information about the company's business. Your company must make extensive disclosures about its business. Among these are those items cited in the list below:

- A company's business plan, particularly if it has less than three years' operating results;
- A description of its properties;
- Information relating to foreign operations, if any;
- Amount of research and development expenditures;
- Regulations affecting the industry and company;
- Pending or threatened legal proceedings; and
- Revenues, profits, assets, products and services, product development, major customers, order backlog, inventory, patents, suppliers, and the competitive position of each major industry and geographic segment of the company.

Financial information. The SEC has specific and sometimes complex rules regarding the content and age of the financial statements that must be presented in a registration statement, and your company's accountants can be invaluable in helping you comply with these rules. In a Form S-1 registration statement, a company must generally present the items listed below:

— Audited balance sheets as of the end of the two most recent fiscal years;

— Audited statements of income, cash flows, and changes in stockholders' equity for each of the past three fiscal years;

— Selected financial information (summarized from the balance sheets and income statements) for the past five fiscal years;

— Separate financial statements of businesses acquired or to be acquired. The financial statement requirements range from one to three years depending upon whether certain criteria are met;

— Interim financial statements (also referred to as stub-period financial statements), required if the fiscal year-end financial statements are more than 134 days old at the expected effective date of the registration statement. Interim financial statements can be presented in a condensed format and generally are not audited. However, it is not unusual for an underwriter to request that a review of the interim financial statements be performed by your independent accountants and many accounting firms require such a review as a matter of policy.

  It should also be noted that the latest audited financial statements can not be more than one year and 45 days old at the date the registration statement becomes effective; and

  Pro forma financial information, i.e., financial statements or financial tables prepared as though certain transactions had already occurred. While the need for pro forma financial information most frequently occurs in connection with business combinations, the rule also applies to other events. For example, the disposition of a significant portion of a business may also necessitate pro forma financial information. In addition, there could be other events or transactions for which pro forma financial information may be required if the pro forma financial information would be material to investors, including situations in which:

  - The registrant's financial statements are not indicative of the ongoing entity (e.g., tax or cost-sharing agreements will be eliminated);
  - Dividends are declared by a registrant subsequent to the balance sheet date;
  - Redeemable preferred stock or debt converts to common stock at either the effective or closing date of an IPO;

TIP

Management knows the business the best, so take an active role in providing direction in the drafting process. Resist the temptation to allow the underwriters or attorneys to perform significant amounts of drafting as this could result in a registration statement that has deviated from reality.

- Other changes in capitalization occur at or prior to the closing date of an IPO; and
- An issuer was formerly a subchapter S corporation, a partnership, or a similar tax-exempt enterprise.

Information about the company's officers, directors, and principal shareholders and their compensation. Form S-1 requires that your company identify and describe the business experience of its executive officers and directors; their compensation (including information on stock options, bonuses, profit-sharing plans, and other benefits); the security holdings of directors and principal shareholders; transactions with and indebtedness of officers, directors, and principal shareholders; and the identity of transactions with, and compensation paid to, its promoters.

MD&A. In this section, management provides investors and users information relevant to the assessment of the financial condition, results of operations, liquidity, and capital resources of the company, with particular emphasis on the company's prospects for the future. MD&A continues to be an area of focus for the SEC staff when reviewing registration statements and inevitably results in comments (particularly the lack of forward-looking information required by each of the major sections of MD&A). It is therefore imperative that this section be carefully drafted. It must be written as objectively as possible, pointing out both favorable and unfavorable developments, and should be written from the point of view of the management of the company. It should include the following:

— Results of operations. A comparison of the income statement amounts for each period presented and an explanation of the reasons for any material changes should be incorporated. The MD&A should also discuss reasons for any recent positive or negative trends, as well as the quality of the company's earnings. Any known trends or uncertainties that have had or are expected to have a material impact on the company should be analyzed as well. Changes in significant balance sheet items must also be discussed.

— Liquidity. Any known trends or any known demands, commitments, events, or uncertainties that will result in or that are reasonably certain to result in the company's liquidity increasing or decreasing in any material way should be identified. Any course of action the company has taken or proposes to take to remedy any deficiencies should be indicated. Also, the internal and external sources of liquidity should be identified and described, and any material unused sources of liquid assets should be briefly discussed.

— Capital resources. A description of the registrant's material commitments for capital expenditures, the general purpose of such commitments, and the anticipated source of funds needed to fulfill such commitments, should be included in the MD&A. Further, any known material trends, favorable or unfavorable, in the company's capital resources should be divulged.

- Disclosure about off-balance sheet arrangements, aggregate contractual obligations, and other matters. This section should include, among other things, an explanation of off-balance sheet transactions and arrangements, including relationships of the company with unconsolidated entities or other persons that have or are reasonably likely to have a current or future material effect on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, or capital resources.

Companies must also present the above information on a basis, if the company operates in multiple segments as defined by the accounting rules, to provide a more complete understanding of the business.

- Other disclosures. Other disclosures that are required in a registration statement include (but are not limited to) the items listed below.

  - Legal proceedings, if any;
  - Interests of named experts and counsel; and
  - Certain relationships and related transactions.

Part II – Information not required in the prospectus

This part includes disclosures regarding the expenses associated with the issuance and distribution of the securities, the indemnification of directors and officers acting for the company, any sales of unregistered securities within the last three years, undertaking representations made by the company acknowledging that it will keep the registration statement and prospectus current, various exhibits (such as certain material contracts entered into by the company, articles of incorporation and bylaws, underwriting agreement), and various required financial statement schedules.

Sources of SEC technical requirements

The form and content of registration statements, including the requirements for most financial statements and other financial information to be included in the registration statement, are contained in the following SEC rules, regulations, and interpretations.

- Regulation S-X is the principal accounting regulation of the SEC. It specifies the financial statements to be included in filings with the SEC and provides rules and guidance on their form and content.

- Regulation S-K contains the disclosure requirements for the non-financial statement portion of filings with the SEC (otherwise referred to as the "forepart" of the document).

- Financial Reporting Releases (FRRs) are designed to communicate the SEC's positions on accounting and auditing principles and practices. They are used to adopt, amend, or interpret rules and regulations relating to accounting and auditing issues or financial statement disclosures.

- Staff Accounting Bulletins (SABs) represent interpretations and practices followed by the SEC staff and, although not formally approved by the SEC Commissioners, they are generally required to be followed by registrants.
- Industry guides are intended to assist registrants in the preparation of registration statements; they outline policies and practices required by the SEC staff relative to specific industries. Industries covered by the guides include oil and gas, mining, banking, insurance, and real estate.
- Regulation S-B specifies the form and content of financial statements, as well as the disclosure requirements for the non-financial statement portion of filings for small business issuers. Regulation S-B is a simplified and integrated version of Regulations S-X and S-K.
- Regulation S-T governs the preparation and submission of documents filed via the SEC's Electronic Data, Gathering, Analysis, and Retrieval (EDGAR) system.

Commencing in 1996, virtually all documents processed by the SEC, including filings by first-time issuers, are required to be submitted electronically via EDGAR. The SEC has established an EDGAR filer support phone line to assist registrants (202-942-8900). Copies of documents filed with the SEC using EDGAR may be obtained by accessing the Internet at the SEC's Web site: http://www.sec.gov. The general and specific instructions to the relevant "Forms" (S-1 etc.) are also helpful.

Performing due-diligence procedures

Throughout the registration statement preparation process, the entire IPO team will perform necessary procedures to provide a reasonable ground for belief that, as of the effective date, the registration statement contains no significant untrue or misleading information and that no material information has been omitted. These procedures are referred to as due diligence and are performed primarily in response to the 1933 Act, which will hold all parties participating in the registration liable for any material misstatements or omissions in the registration statement. (Due diligence serves as the primary defense in any actions brought against the parties, other than the issuer, under this section of the 1933 Act.)

Due-diligence procedures entail reviews of your company and its management including, but not limited to, visiting facility sites, reviewing significant agreements and contracts, financial statements, tax returns, board of directors and shareholders' meeting minutes, and performing various analyses of the company and the industry in which it operates, by the attorneys and underwriters.

Your attorneys and your underwriter's attorneys will also distribute questionnaires to the directors and officers of your company requesting them to review, verify, and comment on the information contained in the draft registration statement. In addition, the directors and officers may be interviewed by the attorneys.

Further, "keeping current" procedures are performed by the independent auditors to ascertain whether anything has occurred up to the effective date of the registration statement with respect to the company's financial position or operations that would have a material effect on the audited financial statements included in the registration statement.

Due diligence also encompasses the reading of the entire registration statement by all parties involved in its preparation to ensure that there exist no material misstatements, omissions, or inconsistencies.

In addition, as part of their due-diligence procedures, underwriters request comfort letters from your independent auditors with respect to information that appears in the registration statement outside the financial statements and on events subsequent to the accountants' report date. It is common for underwriters to request comfort on as much information as possible. Generally, the more information the underwriters seek comfort on, the more expensive the process becomes. In light of this, and to avoid any misunderstandings and undue time delays, it is important that you, the auditors, and underwriters agree, in the early stages of the registration process, on the information on which the auditors will be giving comfort.

Generally, two comfort letters are issued to the underwriters, one at the time that the underwriting agreement is signed (generally the pricing date) and an updated letter at the closing date. After the registration statement is filed, but before it becomes effective, the principal underwriter holds a due-diligence meeting. The due-diligence meeting is attended by the principal underwriter and often by members of the underwriting group, as well as by your company's principal officers, counsel for your company, counsel for the underwriter, and the independent accountants. At this meeting, the members of the underwriting group are afforded the opportunity to exercise due diligence as to the proposed offering in that they may ask any questions concerning the company and its business, products, competitive position, recent developments in finance, marketing, operations and other areas, and future prospects.

DAYS 61-90 – Filing the registration statement with the SEC

Pre-filing conference with the SEC

Prior to filing the initial registration statement with the SEC, some companies hold a pre-filing conference with the SEC. A pre-filing conference is recommended whenever important accounting or business issues need to be resolved and those problems are of sufficient magnitude to warrant the meeting. This conference is usually attended by the principal financial officer of the company, who should articulate the company's position, together with representatives from the company's independent accounting firm and, generally, outside counsel. The primary advantage of holding such a conference is that it may speed up the review process as the company may avoid any last-minute delays.

TIP

There is a natural tendency for underwriter's counsel to request as much comfort as possible as the related cost is borne by the company. Consequently, management should insist on being involved in the negotiation of what will be included in the comfort letters.

TIP

There are numerous opportunities for schedule slippage during the IPO process. Some of it may be unavoidable, but strive to maintain your timetable. For each unscheduled delay, your management team must balance their potential costs (new required interim financial information, a missed market window, or a less enthusiastic underwriter) against the costs of hasty decisions (expenses or problems with the SEC).

Filing and SEC review

Upon completion of the draft registration statement, it is sent to the printer. You will want to ensure that this draft is somewhat final, so as to avoid unnecessary reprinting/amending costs at the printer. However, it is common for several lengthy drafting sessions to occur at the printer. When the registration statement has been completed, the document, including exhibits, is filed with the SEC by electronic transmission through EDGAR. The registration statement must contain appropriate signatures in typed form; each signatory must manually sign a signature page acknowledging inclusion of his or her typed signature in the electronic filing. This signature page must be retained by the company for a period of five years.

Once filed with the SEC, registration statements are processed and reviewed by the staff of the Division of Corporation Finance, generally consisting of an attorney, an accountant, and/or a financial analyst. The group may also consult with other staff members familiar with a particular industry (such as mining or petroleum engineers). The staff reviews the documents to determine whether there is full and fair disclosure, particularly to determine whether the document contains misstatements or omissions of material facts. The SEC staff's review, however, cannot be relied upon to assure the accuracy or completeness of the data.

The review of financial data is performed by a staff accountant who reads the entire prospectus and the remainder of the registration statement to become familiar with the company and its business. The staff accountant may also refer to published annual and interim reports and newspaper articles and the Internet for information regarding the company and its industry. This review is primarily directed at the financial statements, other financial data, and the independent accountant's report. Its purpose is to determine whether the data complies with SEC regulations and all applicable authoritative accounting literature, as well as with various SEC staff interpretations and policies dealing with accounting and auditing issues.

Although securities law contemplates a review of registration statements filed with the SEC, it does not prescribe the specific review procedures. The SEC staff has developed and adopted review procedures that provide for issuance of comments to registrants (and permit necessary registration statement revisions to be made) without formal proceedings. The informal comment technique has proved to be an effective method of communicating and resolving questions and defects before permitting a registration statement to become effective.

Maintaining open communication with the SEC staff serves to expedite the registration process. To save time, company counsel generally maintains close telephone contact with the SEC staff while the registration statement is being reviewed.

Registration statements should be complete at the time the document is filed, including the age requirements of the financial statements having been met. At times, the staff has received a number of incomplete registration statements in an attempt to "get in line" for the review process. The staff generally will not review incomplete registration statements. If a registrant believes there are extenuating circumstances and the staff should review an incomplete filing, the matter should be approved by the staff prior to submission.

The waiting period

Once the registration statement has been filed, the "waiting period" or "cooling-off" period begins and continues up to the effective date of the registration. During this period, there are restrictions on the activities the company and the underwriter can undertake. During the waiting period, the underwriters may accept "indications of interest" from potential purchasers, but no actual sales can be made until after the effective date.

DAYS 91-100

Responding to the SEC letter of comment and preparing the amended registration statement

After review of the registration statement, the staff typically issues a letter that sets forth questions, possible deficiencies, and suggested revisions. The letter, referred to as a comment letter, is generally mailed or faxed to the company's legal counsel.

Submission of a carefully prepared registration statement usually limits staff comments. While differences of opinion sometimes exist as to the propriety of a particular comment or request, most of the comments and suggestions made by the staff prove to be constructive.

Each comment in the staff's letter of comment must be addressed and resolved in writing before the registration statement can become effective. If revisions are necessary, they are made in an amended registration statement that is also filed via EDGAR.

In addition, significant developments often occur during the period subsequent to filing of the initial registration statement and prior to final SEC approval and these, of course, must be reported. If a development is materially adverse, for example, it would obviously affect the offering's attractiveness. Conversely, a positive development, such as the favorable settlement of a major pending lawsuit, might remove any uncertainty about your company and its future. In other words, any interim developments that materially affect your company and its prospects must be disclosed via amendments to the initial registration statement.

TIP

If your company has any new or unusual accounting and/or disclosure issues, you may want preliminary SEC clearance before you go to print, to save both time and considerable printing expense. The SEC will permit a prefiling review in which you and your advisors may review such matters with them. These issues may be more easily handled earlier in the process rather than later, in the SEC's comment letter. If you or your advisors consider any of your company's issues unusual or groundbreaking, this option may be for you.

Alternatively, if time is not of the essence, you do not need necessarily to file a printed version of the registration statement with the SEC. You may, therefore, save printing costs by waiting to integrate the SEC's comments before printing the statement. This is sometimes referred to as a "quiet filing," as no marketing efforts occur until after the SEC comments are received and integrated into the statement. This can save a significant amount of expense if the registration statement undergoes material changes as a result of the SEC's review.

You can generally expect it to take approximately 30 calendar days from the time the registration statement is filed with the SEC for the staff to complete its initial review and furnish its comments to you.

In addition to filing the registration statement with the SEC, filings must also be made in the states in which your company intends to offer the securities, as well as with the NASD.

"Silent" filings

Often a company and underwriter will agree to all the terms of an offering, but realize that the timeframe to complete the offering will coincide with a negative marketing environment such as summer vacations or the end-of-the-year holidays. In order to accommodate this problem, to help minimize certain costs, and to aid in "controlling" the market for the company's stock, many companies have taken advantage of "silent" or "quiet" filings.

Prior to the mandatory use of EDGAR, these filings entailed sending a written registration statement to the SEC for their initial review and waiting until all SEC staff comments were resolved prior to printing the registration statement and prospectus, i.e., the first printed version was the amended registration statement. As such, the selling effort did not take place until all SEC staff comments had been resolved. While the "silent" filing was always a matter of public record, with the mandatory use of EDGAR and the advent of electronic filing tracking services, knowledge of and accessibility to the "silent" filing by the public is now much easier. Even so, publicity can be kept to a minimum by not distributing a "red herring" prospectus or mentioning the transaction in company press releases.

This type of filing allows the SEC staff time to review your registration document and usually allows your company time to complete one more quarter of results. This strategy allows difficult accounting or disclosure issues to be resolved with the staff or the slow marketing period to pass without hurting the offering's perception in the marketplace.

Commencing the selling effort

No offering of securities, either orally or in writing, is permitted before the registration statement is initially filed with the SEC. These rules are very strict, and your company must be careful not to generate undue publicity about itself that could be construed as an attempt to stimulate interest in its securities.

After the initial filing, however, and concurrent with the preparation of the amended registration statement, SEC regulations do permit certain types of promotional activities within the brokerage community, such as those noted below.

The preliminary prospectus or "red herring"

A preliminary prospectus may be sent to interested institutions or persons prior to the effective date of the registration statement. This preliminary prospectus is a key tool in the lead underwriter's ability to form an underwriting syndicate, made up of various brokerage companies, that will distribute the stock. While in the past companies have occasionally printed and distributed the red herring prior to receipt of SEC comments, companies are now encouraged not to print the red herring until SEC comments have been received, reviewed, and incorporated into the draft prospectus.

SEC rules require that this prospectus substantially conform to the requirements of the 1933 Act and that the cover page bear the caption "Preliminary Prospectus." Prior to the full implementation of EDGAR, this language was required to be printed in red ink (hence the term red herring). The following statement must be printed on the cover in type as large as that generally used in the body of the prospectus:

{Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of these securities in any State in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such State.}

SEC rules also stipulate that the preliminary prospectus may omit the offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, or other matters dependent on the offering price.

Tombstone ads

Companies may place tombstone ads in various periodicals announcing the offering and its dollar amount, identifying certain members of the underwriting syndicate, and noting where and from whom a copy of the company's prospectus may be obtained. Tombstone ads are not intended to be a selling document; their main purpose is to assist in locating potential buyers who are sufficiently interested in the security being advertised to obtain a statutory prospectus. Tombstone ads may be published once the registration statement has been filed; however, typically they are not published until after the effective date of the registration statement.

Financial analysts' meetings or "road shows"

For potential investors to learn about the company, your underwriter will arrange meetings, called "road shows," with financial analysts, brokers, and potential institutional investors. These meetings are generally attended by your company's president and key management (such as the chief technical officer or chief financial officer) and may take place in many different locations throughout the country or the world, if you have an international offering.

It is vital that your management team be well prepared for these meetings. This can not be emphasized enough. You should not assume that the prospectus is able to "stand on its own" — anticipate potential questions concerning specifics on your company and its plans and know the answers, as the credibility projected by your management team in its presentation and their ability to respond to potential investors' and brokers' questions will be a major influence in the success of the offering.

TIP

When it comes to road shows, form may matter almost as much as substance. Road shows allow you to tell your corporate story, but they also enable you to showcase the talent, caliber, and integrity of your management team through an organized, orchestrated, smooth presentation. It can be one of the most important elements of a successful offering. Maximize the value of your road show through planning, preparation, and practice! This is not the time to cut corners. Hire an outside public/investor relations or communications firm to coach you if you or your management team has limited speaking and presentation experience.

The "road shows" represent a critical part of your company's selling efforts, since it is here your management team promotes interest in the offering with the institutional investors. This can be a very grueling process since the span of time can last up to two weeks with a number of presentations a day. In addition, you can not discount the fact that in an active market it becomes more difficult to pique institutional investors' interest if they are going through three to five "dog and pony" shows a day.

Undoubtedly, your underwriters will play a significant role in preparing your management team for these presentations. Additionally, some companies have sought assistance from professional investor relations organizations. Although you may have a good "story" to tell, these advisors can help focus it to an investor's orientation.

Negotiating and signing the price amendment and the underwriting agreement

By the time the registration statement has been filed, your company and the underwriter have "generally" agreed on the securities — both in number of shares and dollar amount — to be sold. However, as mentioned in Chapter 4, the final price at which to offer the securities to the public, the exact amount of the underwriter's discount, and the net proceeds to the registrant have not yet been determined. The negotiation and final determination of these amounts depend on a number of factors, including past and present performance of your company, current conditions in the securities markets, and "indications of interest" received during the road show.

For example, in establishing an offering price, the underwriters will look at a multiple of earnings or cash flow based upon that experienced by similar companies. These multiples may be applied to the company's most recent results of operations or projected future earnings based upon the outlook of the company's growth curve. The underwriter will also examine the current stock market price and multiples of companies comparable to your company.

Timing also plays as important a part as any other factor in determining the final offering price of the shares. Almost any company that went public during the late 1960s and mid-1980s (great bull markets) would have done so at a higher offering price than in the mid-1970s (the worst bear market since the 1940s). In addition to cyclical market factors, particular industries go through "hot" and "cold" periods. Unlike the private sale of stock, where negotiations can be in the form of face-to-face meetings, stock sold through the public market is often priced by market psychology.

Another consideration is the anticipated aftermarket share value. That is, after a period of trading, the stock should settle at an aftermarket share value, and ideally, the offering price should reflect a discount from this aftermarket share value. In other words, the initial offering price should allow for a small appreciation of the price per share in the aftermarket immediately subsequent to the IPO. An offering at the high end of a range may not provide adequate investor return, resulting in a weak or depressed aftermarket, while pricing at the low end may result in a run-up immediately following the offering (thus lost opportunity for the company or selling shareholders).

Market perceptions of the risk inherent in a company's stock are sometimes related to the per-share price. That is, a company that offers its shares at a price of $8 may be perceived to be offering a more speculative stock, while a $15 stock price may not be so perceived. At the other end of the spectrum, an IPO price of $25 may be considered overpriced.

In addition to the price, the number of shares offered should be sufficient to ensure broad distribution and liquidity.

Upon completion of negotiations with the underwriter — usually about the time the registration statement is ready to become effective and the road show schedule is over — the underwriting agreement is signed by authorized representatives of your company and the underwriter. Also at this time, the final amendment to the registration statement is prepared, including (as applicable) the agreed-on offering price, underwriter's discount or commission, and the net proceeds to the company. This amendment is called the price amendment and is filed with the SEC.

In an effort to simplify the filing requirements associated with the final pricing amendment, the SEC passed a rule allowing companies to omit information concerning the public offering price, price-related information, and the underwriting syndicate from a registration statement that is declared effective. In such cases, the information omitted would either be included in the final prospectus and incorporated by reference into the registration statement or included in a post-effective amendment to the registration statement.

If the staff of the SEC's Division of Corporation Finance has no important reservations with respect to the registration statement, your company and underwriter will customarily request that the offering be declared effective immediately — referred to as requesting acceleration. If acceleration is granted, the underwriter may proceed with the sale of securities to the public.

The offering

7 DAYS AFTER THE OFFERING – Holding the closing meeting

The closing date — generally specified in the underwriting agreement — is usually within three to five business days after the effective date of the registration statement. At closing, your company delivers the registered securities to the underwriter and receives payment for the issue. Various documents, including an updated comfort letter prepared by the independent accountant, are also exchanged.

TIP

There is no room in your new life as a public company for capriciousness in regard to your use of proceeds from your offering. Use proceeds on the items listed in the prospectus. If you do otherwise, you risk losing credibility for future financings and you may have to explain differences to the SEC.

6 Life as a public company

Your company should begin acting like a public company as early as two years before the IPO. This means getting comfortable with the rhythm of quarterly and annual reporting requirements, their content, and costs. It also means proactively managing your company's reputation — communicating regularly with investors and analysts and the financial media to maintain a positive image and making sure your story is being told accurately. The public's perception of your company has a direct effect on the value of your stock. Do not underestimate it.

Maintaining investor enthusiasm

Once your company has been taken public, considerable effort must be expended to maintain its market position. If investor enthusiasm for your company is not maintained, trading will decline. Should that happen, and as a consequence your company's shares are thinly traded, the benefits sought from the IPO (such as liquidity through a future secondary offering) will not be realized. Thus, effective distribution and support of the stock, as well as continuing security analyst interest, is necessary after the IPO.

A strategy for after-market support can be determined with the assistance of a financial public relations firm. This strategy usually includes choosing an individual within your company to handle shareholder relations. This process ensures that your company will release information that is uniform and accurate.

A public company's performance, as perceived by the market, is reflected in the value of its stock. Management faces the pressure of balancing short-term productivity with long-term goals. Negative developments, such as the release of lower-than-expected earnings, may adversely affect the stock's value. Management will need to ensure that all communications with external parties explain fully the results of the company. This transparency in reporting will in turn create greater market trust.

Earnings are not the only factor that affects the public's perception of your company. Even after your company goes public, it should strive to maintain (or improve) the characteristics that it desired to possess prior to becoming a public company.

These characteristics, modified for a post-IPO company, are:

— Is your company demonstrating a sustained or increasing growth rate that is high enough to attract/satisfy investors? Your company must continue to grow at a rate satisfactory to investors; its share value will be determined to a large extent by the earnings potential of your company.

— Are your company's products or services highly visible and of interest to the consuming and investing public? Your company should project a positive image to its investors, customers, and community. This is important, since the attitude of the public may sway the stock's value.

— Is management capable and committed? Management plays a key role in the way a company performs; therefore, it is essential that management remains innovative, committed, and capable.

Meeting reporting requirements

As a public company, you are now required by the SEC, under the 1934 Act and the Sarbanes-Oxley Act of 2002 (see Appendix A — The SEC and Securities Regulations, page 79, for more detail) to file certain periodic reports to keep the investing public informed. This requirement will continue as long as the investor and asset tests are met. In fact, you should have discussed your obligations under the various regulations with your attorneys and accountants, even before starting the going-public process, to be certain that these obligations can be met.

Legal counsel should also be consulted to confirm the SEC requirements pertaining to the form, content, and timing of specific reports. Your financial public relations firm can assist with annual reports to shareholders. The table below presents an overview of the basic SEC reporting requirements for public companies.

Basic SEC reporting requirements

Form 10-K or 10-KSB	Annual report to stockholders (conforming to SEC specifications). It discloses, in detail, information about the company's activities, financial condition, and results of operations. It also contains the company's audited annual financial statements.
Form 10-Q or 10-QSB	Quarterly report required for each of the first three quarters of the fiscal year. It includes condensed financial data and information on significant events. In addition, SEC rules require that the interim financial information included in the quarterly report be subject to a review by an independent accountant prior to filing.
Form 8-K	Report filed for significant events such as: an acquisition or disposal of assets; a change in control; bankruptcy; a change in independent accountants; or resignation of directors because of disagreement with the registrant. In March 2004, the SEC issued final rules relating to additional Form 8-K disclosure requirements, which are effective on August 23, 2004. These rules expand the number of events that are reportable under Form 8-K and shorten the deadline for the filing of the Form 8-K for most events to four days subsequent from the day of the event. Among the items that are required to be reported on Form 8-K that were not reported under the form previously are the entry into a material definitive agreement, creation of direct obligations or obligations under off-balance sheet arrangements, a commitment to a plan involving exit or disposal activities, and asset impairments. ***Due within 5 to 15 days of event.***
Proxy or Information Statements	Data furnished to shareholders so they can decide how to assign their proxies (votes). ***Due dates vary.***

Filing deadlines for Forms 10-K and 10-Q have been shortened beginning in calendar 2004 for issuers once they meet the definition of an accelerated filer. The phasing in of accelerated flings is summarized below.

For Fiscal Years Ending On or After	Form 10-K Deadline	Form 10-Q Deadline December 15, 2003
December 15, 2003	75 days after fiscal year end	45 days after fiscal quarter end
December 15, 2004	60 days after fiscal year end	40 days after fiscal quarter end
December 15, 2005	60 days after fiscal year end	35 days after fiscal quarter end

Public companies are also required to provide annual reports to shareholders, and to include in them financial information similar to what is in Form 10-K when soliciting proxies relating to annual meeting of shareholders at which directors are to be elected.

To meet the various reporting requirements imposed on them, public companies must maintain an adequate financial staff, supported by legal counsel and knowledgeable independent accountants. See “Sample Compliance Calendar,” page 57, for more detail.

Timely disclosure of material information

A public company should disclose all material information (unless there is a legitimate reason for not doing so), both favorable and unfavorable, as promptly as possible. Information that is generally considered material includes: significant financial transactions; new products or services; acquisitions or dispositions of assets; dividend changes; and top management or control changes.

Disclosure of such information should be made as soon as (1) it is reasonably accurate, and (2) full details are available to your company. This information is usually disseminated by press releases; however, your company may decide to also send announcements directly to your shareholders. Generally, the need to disclose information should be discussed with your legal counsel.

It should be noted that where a release or public announcement discloses material nonpublic information regarding a registrant’s results of operations or financial condition of an annual or quarterly period that has ended, Item 12 requires that the release be identified and included as an exhibit to a Form 8-K filing. Note that Item 12 does not apply to disclosure in annual 10-K or quarterly 10-Q report.

Safe harbor provisions

The Private Securities Litigation Reform Act of 1995 (Reform Act) provides a “safe harbor” for forward-looking statements, such as forecasts, projections, and other similar disclosures in the MD&A. A safe harbor encourages registrants to disclose forward-looking information and protects them from investor lawsuits if the forward-looking information does not materialize. This protection does not extend to statements which, when issued, were known to be false. A safe harbor applies to any form of written communication (e.g., press releases, letters to shareholders), as well as oral communications (e.g., telephone calls, analysts’ meetings) that contain forward-looking information.

It should be noted that the safe harbor provision is not available to historical financial statements, nor to forward-looking statements included in IPO registration statements. However, the statutory safe harbor does not replace or alter the current judicial "bespeaks caution" doctrine on which the safe-harbor rules were modeled. The bespeaks-caution doctrine generally provides that, to the extent an offering statement (such as a prospectus) contains a forward-looking statement with sufficient cautionary language, an action brought about as a result of such a statement could be dismissed on those grounds.

The following discussion relates to the application of the rules subsequent to the offering.

To avail itself of the safe harbor provision, the forward-looking information must be clearly identified as such by the company, and must be accompanied by a cautionary statement identifying the risk factors that might prevent the realization of the forward-looking information. In meeting this criteria, two points should be noted.

— *The forward looking statements should be specifically identified. A general statement such as "certain information contained in this annual report is forward-looking..." does not clearly identify the forward-looking statements.*

— *Every risk factor need not be identified to gain protection under the safe harbor. "Boilerplate warnings," however, will not suffice as meaningful cautionary language.*

The statutory safe harbor does not require a company to update a forward-looking statement. While companies are not legally required to update such information, material changed circumstances may nonetheless have to be disclosed as dictated by MD&A disclosure requirements. Further, from a business and investor relations standpoint, companies should consider updating such information.

A new public company should ensure that, when disclosing forward-looking information in annual reports and press releases, the requirements for using the safe harbor provision are appropriately met. Your legal counsel will be invaluable in providing the necessary guidance. Such guidance is particularly essential when forward-looking information is communicated orally (e.g., in conference calls with analysts).

Restrictions of trading on non-public information

Until important information is made public, SEC rules prohibit company insiders from personally trading the company's securities or passing this information to others. Within the company, material information should be kept confidential. Persons privileged to this information must treat it as confidential until it is released to the public. In the past, violators of this rule have been dealt with harshly (fined or otherwise penalized).

Fiduciary duties

Fiduciary laws require that transactions between a company and any of its officers, directors, or large shareholders be fair to the company. These laws apply to both privately and publicly held companies. However, since the officers and directors of a privately held company are usually its only shareholders, the ramifications of fiduciary laws are less than what they might be for a publicly held company.

Fiduciary laws must be carefully observed after a public offering due to the interests of the new shareholders. Whenever there is a potential conflict of interest between the company and its fiduciaries, management should obtain independent appraisals or bids and independent director approval (or even shareholder approval), depending on the nature and significance of the transaction.

Costs

As mentioned previously, a further consequence of a company's being publicly held is the expense it entails. Significant costs and executive time is often incurred when periodic reports are prepared and then filed with the SEC. Board and shareholder meetings/communications may also be expensive.

Because of its responsibilities to the public shareholders, the board of directors and the audit committee are significantly more important in a public company. If the board were previously composed entirely of insiders, a number of outside directors would need to be added (which will likely result in incurring additional costs) to satisfy the NYSE or the NASDAQ National Market listing requirements.

Sample compliance calendar – assumes that the registrant is an accelerated filer

6/30/04	Fiscal Year 2004 Second Quarter End
7/17/04	Effective Date of Registration Statement – Company becomes a reporting company
8/09/04	Second Quarter Form 10-Q due (unless 6/30/04 financials are included and discussed in Registration Statement)
9/30/04	Fiscal Year 2004 Third Quarter End
11/09/04	Third Quarter Form 10-Q Due
12/31/04	Fiscal Year 2004 Year End
2/15/05	Schedule 13Gs due at SEC
2/15/05	Form 5s due at SEC
3/01/05	Initiate Proxy search
3/15/05	File Preliminary Proxy Statement, and form of Proxy with the SEC and NASD, if necessary
3/01/05	Fiscal Year 2004 Form 10-K due
3/30/05	Fiscal Year 2005 First Quarter End
4/02/05	Record Date – Annual Meeting of Stockholders
4/16/05	File Definitive Proxy Statement, form of Proxy and Annual Report to Stockholders
4/16/05	Mail Definitive Proxy, form of Proxy and Annual Report to Stockholders
5/05/05	First Quarter Form 10-Q due
5/30/05	Annual Meeting of Stockholders
7/16/05	Section 11(a) Earnings Statement available to security holders as soon as possible covering a period of at least 12 months beginning after the effective date of the Registration Statement

Note: If a filing date falls on a Saturday, Sunday, or holiday, the document may be filed on the next business day (Rule 0-3(a)).

7 Other considerations

Even before you begin drafting the registration statement and interviewing investment bankers, you should review your company's compensation design to ensure that it is competitive and can stand up to public disclosure. As previously mentioned, making changes to stock grant and option plans should be done long before the IPO to avoid close scrutiny and possible charges. In addition, key shareholders should take the opportunity to put into place key tax planning strategies to optimize their financial goals following the IPO.

Compensation planning and design

Basic considerations

Companies considering a public offering should ensure the placement of a well-conceived compensation program which will support the company's strategy and competitive positioning. The critical reasons why companies should look at compensation are to:

Support the company's strategy via compensation programs

Compensation programs exist to effectively attract, motivate, and retain personnel to execute corporate strategy. As a public company, a key strategy is to increase shareholder value. The compensation program, therefore, should adequately communicate the performance measures that drive value, and share a portion of the value creation with employees.

Consider competitive pay levels and mix

Company salary data for top executives will be available to shareholders and the general public for what is probably the first time. Registration statements and annual proxy disclosures require detailed reporting of base salaries, annual cash bonuses, perquisites and benefits, stock option grants, and any other long-term incentive grants. Specific data is required for the CEO and the four other most highly paid officers, as determined by salary and annual bonus. It is critical that compensation is reasonable, relative to industry practices and to the company's strategy and performance. Unreasonably low pay will attract recruiters, while high pay will attract unwanted criticism by investors and analysts.

Satisfy investor desires for management "ownership"

Investor groups generally want management and directors to hold an ownership interest. This helps ensure that adequate management attention is given to increasing shareholder value. It also provides retention incentives for key executives, particularly if grants vest over time. In fact, in a special study reported in *The New York Times* on executive pay published in April 2000, indicated that most companies require chief executives to own stock worth three to five times their annual salary. The ratio declines for lower-level executives, usually down to one and a half times salary. The ownership interest may be actual shares, or more commonly, options to purchase shares in the future.

Shift accountability for executive pay to an independent board committee.

As a public company, the Board of Directors has the ultimate fiduciary responsibility for executive pay levels and programs. Accordingly, almost all public companies have independent compensation committees to oversee executive pay decisions. Also, in some circumstances, an independent or disinterested committee may be required, e.g., a committee would typically address the company's policies and programs on qualifying compensation to executive officers for deductibility under the $1 million dollar cap, as required by the Internal Revenue Code, as well as address pre-approval by the committee and/or the Board to ensure compliance with certain Federal securities laws on short-swing acquisitions and sales of company stock by company officers and owners.

Prepare for increased investor and media scrutiny

At times, investors and other interested groups at shareholders' meetings are armed with executive pay data. Questions may be raised as to both reasonableness and competitive nature of the current total rewards program against such data. Thus you should be prepared to justify pay strategy and practices. Also, national and local media regularly publish pay data for public companies; particularly pay that is at higher than normal levels.

Compensation initiatives

Outlined below are planning and analysis initiatives that should be considered to ensure an appropriate compensation program.

- A review of competitive total compensation levels and mix. Consider base salaries, annual bonuses, long-term incentives (primarily stock options for pre-IPO companies), perquisites, and benefits.

- The creation of a new-hire pay structure to competitive practice for each position, based on real-time external research (not necessarily just on surveys that are out of date prior to publication). Consideration should be given to salary adjustments based on the value created by the incumbent — value based on performance, increased breadth of responsibilities, and success in helping teammates to create value.

- An appropriate annual incentive plan that will (1) assess performance measures driving shareholder value over the short- and long-term, and (2) reward performance based on: minimum, target, and maximum performance; eligibility; form of payment; and timing of payment.

- The establishment of an independent board committee to (1) oversee executive compensation (both from a strategic and regulatory standpoint), and (2) to define the role played by the CEO and management in decision-making.

- The establishment of executive employment contracts, with change-in-control provisions, for key contributors. It is hard to anticipate what will happen after a public market is established. Make sure that key contributors can be retained under adverse circumstances, and that they are taken care of in the event of a merger with another company, provided, however, that

the events that constitute a triggering change-in-control event should not be defined so broadly as to provide accelerated and unduly generous payouts to executives for an event which would not be considered "adverse."

— The assessment of competitive Board of Directors' compensation levels and programs. Directors of the public entity will anticipate remuneration commensurate with their time and efforts. Competitive retainers and fees are expected. Many companies grant restricted stock and stock options to directors, sometimes in lieu of cash, to allow tax deferral and to align directors' interests with stockholders. In fact, some companies have altogether cancelled cash compensation and pension benefits to non-employee directors, and, instead, have issued options or other forms of equity.

— Consider broad-based equity programs, such as all-employee stock options or an employee stock purchase plan.

This is also a good time to assess the design and administration of employee benefit programs, including 401(k), profit sharing and other retirement plans, healthcare, and life and disability if you haven't already.

Stock options

Equity-based compensation, particularly stock options, have taken the primary role as a means of compensating valued employees without a cash outlay. A company may utilize stock options as an integral part of a program to secure equity capital or to achieve widespread ownership of its stock among its employees. Equity packages are often calibrated in terms of a percentage of ownership of the company, as a means of strengthening the ownership mentality of the employees.

Option types

The Internal Revenue Code provides for two basic types of stock options: Incentive Stock Options (ISOs) and Nonqualified Stock Options (NSOs). An ISO is not taxed as income to the employee at the time the option is granted, or at the time the employee exercises the option and buys the stock. The exercise of an ISO does, however, impact the alternative minimum tax calculation; therefore, depending on personal circumstances, the exercise could result in a tax liability. An ISO is intended to provide for favorable tax treatment at the time the employee sells the stock in that the proceeds on sale are taxed at capital gains rates, not ordinary income rates (which would also be subject to income and tax withholdings, e.g., FICA/FUTA). As a trade-off for this special treatment, there are certain requirements on the terms and stock holding periods of an ISO (which are discussed in detail in the Internal Revenue Code). Conversely, any gain on an NSO is taxed as compensation at ordinary income rates at the date of exercise (up to 39.6%), and is subject to general employment withholding taxes. Once that ordinary income on the exercise of a NSO is recognized — difference between the exercise price and the fair market value of the stock on the date of exercise — any future appreciation of the stock may be taxed at the long-term capital gains rate (generally 20%) provided that the stock has been held for at least one year.

ISOs are a great benefit for executives, but the company loses the tax deduction for the increase in stock value from grant to exercise (which is otherwise available with an NSO). Since the potential tax benefits of ISOs are greater for highly paid individuals, and the after-tax cost to the company is greater than NSOs, ISOs are often reserved for executives, with other optionees receiving NSOs. In the technology and Internet sectors, ISOs are typically granted up to a prescribed dollar limit (the maximum limit is $100,000 exercisable in any given year) as the issue of corporate deduction is moot or limited.

Pre-IPO stock options

One of the most important components of compensation planning is the creation and implementation of a stock option plan. The primary purpose of stock options is to motivate employees to increase company market value. Before an IPO, major value-creating initiatives include: developing new products and markets; obtaining regulatory approvals; increasing the size and quality of earnings; exhibiting a strong growth pattern; and establishing a credible management team. Stock options granted on or after the IPO will not capture the value that management generated prior to the offering. Granting options immediately prior to an IPO may create a compensation charge issue, due to the SEC rules on "cheap stock." See "Current Regulatory and Disclosure Issues," page 12, for more detail.

$1 million cap

For the top five named executive officers in public companies, the Internal Revenue Code places limits on the deductibility of pay above $1 million. This problem is not confined to the largest companies, since smaller company executives realizing significant stock option gains in a single year could easily exceed the limit. Not only would this circumstance result in a loss of the deduction, but the company could also face unwanted shareholder and media criticism.

However, certain pay — including stock option gains — may be exempt from consideration in the $1 million cap if the compensation is "performance based" and fulfills other specific requirements. Generally, in order for stock option gains to be considered "performance based" compensation (and thereby not counted toward the $1 million cap), the exercise price for the stock options must be at fair market value on the date of grant. There is a limitation on the number of shares underlying the options that can be awarded to any individual during a specified period, and the award must be made by a disinterested compensation committee. Additionally, the plan must be approved by shareholders. Stock option plans established by private companies may be grandfathered and held exempt from the rule indefinitely, even after the public offering (if shareholder approval of the plan is obtained within four years after the IPO). This exemption would continue until the plan is "materially changed" (e.g., increasing the number of shares in the plan). To ensure that the plan is grandfathered following the IPO, the company should fully disclose its provisions in the prospectus according to SEC guidelines, and document the plan in writing. It is unclear whether the IRS will consider grandfathering a stock option plan that becomes effective at the IPO date or is contingent on the IPO event.

Stock option authorization

A key question for any company is, “How many shares should be allocated to the stock option program?” Companies should consider the following factors before setting aside shares:

- economic value of option grants to employees;
- number of eligible employees;
- competitive industry practices; and
- acceptable ownership dilution potential.

The use of stock options differs dramatically within each industry. Many industries (e.g., technology and biotech) make generous allocations of options to employees. A recent (April, 2000) special report by *The New York Times* stated that last year, the nation’s 200 largest public companies handed out options that represented the equivalent of 2.1 percent of their outstanding shares, up from 1.2 percent in 1994. As a result, the average overhang (i.e., the percentage of the company that options would represent if all were exercised) reached 13.7 percent in 1999, well above a 10 percent ceiling that was considered reasonable just five years ago. Broad-based grant programs are also prevalent in some industries. All companies should examine competitive total stock authorization, as well as annual grant levels, prior to finalizing a program.

Stock option alternatives

Companies differ with respect to their industry and industry sector, financial resources, stage of growth, form of ownership, culture, management, and philosophy. Due to these variations, there exists a number of long-term, incentive-type plans. The most common forms of compensation plans will utilize stock options or bonuses based on stock performance. When stock options prove undesirable, a company may utilize other long-term incentive vehicles to motivate and reward executives. These alternatives (for which there are special compensation accounting rules) may include:

- Outright stock grants.
- Phantom stock: These instruments are among the most popular variable plan awards. Phantom stock entitles an employee to receive (at a future date in cash) any increase in stock value. It does, however, have adverse accounting implications resulting in a charge to earnings as the underlying stock appreciates over time. It also does not allow for ultimate favorable capital tax treatment if the shares were actually being held.
- Restricted stock: These grants are of actual stock. The stock is subject to restrictions on sale, until vested by continued employment or the attainment of performance goals. Grants typically include dividend and voting rights. In some cases, vesting may be accelerated, based on the achievement of predetermined performance objectives (e.g., Performance Accelerated Restricted Stock Award Plans, or PARSAPs).

— Stock-for-stock exchange: An equity plan may allow previously owned shares to be accepted as payment for the exercise of stock options, rather than cash.

— Performance units: These are grants of dollar-denominated units whose value is contingent on performance against predetermined objectives over a multiyear period. Actual payouts may be in cash or stock.

— Performance shares: These are grants of actual shares of stock or stock "units" whose payment is contingent on performance against predetermined objectives over a multiyear period. They are the same as performance units, except that the unit value fluctuates with stock price changes, as well as with performance against objectives.

— Deferred compensation arrangements: These are arrangements whereby a company agrees to make cash or stock payments to an employee at a future date. These agreements may be in the form of salary deferrals, profit-sharing plans, or deferred stock units and are often funded by means of corporate-owned life insurance or split-dollar insurance where the cash surrender value and death benefits are owned separately by the company and the individual.

— Employee Stock Ownership Plan (ESOP): This is a tax-qualified defined-contribution retirement plan that invests primarily in a company's common or convertible preferred stock. A company may either contribute cash or its stock to the plan; or, alternatively, the plan may borrow money to purchase the employer's stock. The stock is subsequently distributed to employees under provisions of the plan.

Each of these plans has distinct advantages and disadvantages. When adopting any type of incentive vehicle, a company's primary criteria should be the program's ability to reinforce both the company's strategic business objectives and its supporting compensation philosophy.

Please note that on March 31, 2004, the Financial Accounting Standards Board (FASB) issued an exposure draft (ED) of a proposed standard that, if adopted, will significantly change the accounting for employee stock options (referred to as equity-based compensation or EBC). The ED proposes that EBC will be recognized as an expense under the rules of FAS 123. At this point in time, most companies have designed their stock-based compensation programs to take into consideration the accounting rules under APB Opinion No. 25, which has generally resulted in no accounting expense. For the most part, companies avoided performance-based plans and other designs that could result in charges to income (variable plans under APB 25). However, if companies are reporting under FAS 123 accounting, generally all stock-based plans not settled in cash result in fixed expense (as opposed to variable). Accordingly, if FAS 123 becomes the standard, companies can place greater emphasis on strategic issues when designing incentive plans.

Pre-IPO tax planning for shareholders

Among the many issues that a business owner must consider in taking his or her company public are the tax-planning decisions that traditionally accompany an IPO. There are numerous estate and gift — as well as income tax-planning opportunities — which should be considered. Among these opportunities are outright gifts of property to future heirs, gifts in trust, and other restrictive-type gift vehicles that may transfer significant appreciation to the next generation on a gift/estate tax-free basis. Additionally, there may be the ability to discount the value of a gifted interest because of the lack of marketability and control. The following pages discuss in detail some of these opportunities.

Gift and estate planning

At a person's demise, his or her estate may be subject to estate taxes. Estate taxes can be as great as 60 percent of a person's total assets at the time of his or her death; however, they may be minimized through the transfer of wealth during an individual's lifetime to future heirs. These transfers may take the form of outright gifts, gifting through grantor retained annuity trusts (GRATs), or the creation of family limited partnerships.

Outright gifts

Generally, gifts from one person to another individual will be treated as a taxable gift. Gift taxes are imposed at the same rates as estate taxes. However, the Internal Revenue Code currently allows certain gifts to be made without incurring gift taxes. Under the annual gift tax exclusion, a donor may give $10,000 per year to an unlimited number of donees without incurring gift taxes. For example, a father or mother may give $10,000 annually to each of their six children ($60,000 in total) without incurring gift tax. A married couple may give $20,000 annually to any number of persons, regardless of which spouse holds title to the property.

In addition to the annual gift-tax exclusion, the Internal Revenue Code provides that an individual may transfer up to $600,000 of value in property as lifetime gifts without incurring a cash outlay for the gift tax. The Internal Revenue Code allows this by giving each person a $192,800 one-time tax credit, which is referred to as the unified credit and can be used during his or her lifetime, or at his or her demise. If the unified credit is not used during a person's lifetime, then it can be used at death to transfer $600,000 of value of a person's estate tax free. If the unified credit is used in part during an individual's lifetime, then the remainder of the credit can be used at the person's demise to offset any estate taxes. These credits and exclusions are only available with respect to the imposition of federal estate and gift tax. The state tax treatment varies by jurisdiction.

For an example of the utilization of the one-time tax credit, let's look at an individual who owns a closely held business. For purposes of our example, we will assume an individual, Jack, transfers $600,000 of ABC Co., Class B nonvoting common stock. (The example assumes a ten-year life expectancy).

The benefits of Jack's transferring stock today, rather than at death, amounts to approximately $75,000 in our calculation as follows:

Tax treatment of stock transfers

	Shares transferred today	Shares remain in estate
Amount [1]	$ 600,000	$600,000
Growth (10%) [2]	956,245	956,245
Taxable value	N/A[3]	1,556,245
Estate tax at 50%	N/A	778,123
Unified credit	N/A	(192,800)[4]
Net estate tax	N/A	585,323
Total value before income tax	1,556,245	$ 970,922
Income tax at 33%	510,061[5][7]	N/A[6]
Total value to heirs	$1,046,184	970,922
Benefit		$75,262

(1) Represents the fair market value of the property today. For purposes of this example, the transferor's cost basis in the property is assumed to be zero. Assume that Jack has other, non-appreciating assets that will cause him to be in the 50 percent estate tax bracket.

(2) Assumes assets are invested for pure growth. Taxable dividend or interest income is not considered.

(3) A completed gift of the Class B stock escapes inclusion in the taxable estate.

(4) The $192,800 unified credit is equivalent to excluding $600,000 in assets from estate taxation.

(5) Assumes the maximum 28 percent federal capital gains tax rate and 5 percent state capital gains tax rate. Represents the capital gains tax to be paid when the property is ultimately disposed of by the heirs. This example assumes the disposition of the property by the heirs shortly after the transferor's death.

(6) Assets owned by the estate receive a "step-up" in basis to their fair market value at the date of death, causing no incurrence of income tax. This example assumes disposition of the property by the heirs shortly after the transferor's death.

(7) Assumes married, joint return, with the capital gain income as the only source of income, and the state capital gains tax as the only itemized deduction.

Many business owners often desire to make gifts of an interest in their business but wish to retain control or voting power with respect to that transferred interest. Generally, the Internal Revenue Code will deny gift treatment where the donor of the property retains certain interests. Therefore, it is important that the donor does not retain any rights to the possession of the property, or share in the enjoyment of the income of the property; nor can the donor have the right to vote certain corporate interests. Additionally, gifts must be made currently, in order to receive gift treatment, and cannot have the effect of taking place in the future or at death.

These constraints will present numerous considerations on the part of the donor with respect to the ability of the donor to manage or avoid an unexpected liquidation of the property. It is because of these concerns that an individual may often utilize a trust to hold title to the property, or to place the property in a family limited partnership. These vehicles can provide control and security for the donor with respect to unwanted consumption of the gifted property.

Grantor retained annuity trust

A Grantor Retained Annuity Trust (GRAT) is an irrevocable trust that allows the person setting up the trust (the "grantor") to transfer future wealth at a reduced gift tax cost. A GRAT works particularly well with assets that are expected to appreciate in excess of an IRS benchmark rate of return, which is adjusted monthly to reflect current interest rates. Historically, the benchmark rate of return has ranged from six to 10 percent. If the trust assets do not appreciate in excess of the benchmark rate of return, the assets in the trust are returned to the grantor. Because the value expected from the trust will not materialize if the grantor dies before the trust terminates, the term of the trust should be one that the grantor is likely to survive.

The person who deposits property (such as pre-IPO stock or other property) into the trust is paid by the GRAT an annuity for the term that the trust will be operating. The payment amount is calculated by applying a rate of return, and by determining an annuity payout that will cause the present value of the annuity payments to approximately equal the fair market value of the assets contributed to the GRAT.

If the actual rate of return on the property placed into the trust does not equal or exceed the benchmark rate of return, the grantor will simply receive back (through the annuity payment mechanism) the property placed into the trust, plus whatever appreciation (or depreciation) in value that might have occurred during the trust period. To the extent that the property actually produces a return at a rate higher than the benchmark rate of return, the value created by this higher rate of return will be given to the beneficiaries at the end of the trust term (either outright or in further trust), without the payment of additional federal estate or gift taxes by the grantor.

The annuity payments to the grantor can consist of cash (assuming cash is available to distribute) and/or property (e.g., the original stock, revalued at its then presumably higher fair market value). If there is no cash available to distribute, the annuity payment will consist solely of property.

For income tax purposes, the annuity payments are not themselves taxable as income to the grantor, because the GRAT is considered a "grantor trust." Even though the trust is a separate legal entity, for income tax purposes, the person setting up the trust is taxed on all of the income produced by the assets in the GRAT.

Let us assume that Jack and his wife, Jill, are each age 55, and wish to consider using a GRAT to transfer wealth represented by ABC Co. to their children. Assume that the value (for gift tax purposes, after consideration of any discounts that might be available) of ABC Co. stock is $2 million, and that the trust term will be for 10 years. With a 7.6 percent benchmark rate of return, the gift value of the ability for Jack and Jill to shift appreciation in excess of the benchmark rate for 10 years on $2 million is $7,255*. (If Jack and Jill have not previously used any of their $600,000 exemptions, this gift will reduce those amounts.)

If the stock appreciates at an average rate of 10 percent during this period, Jack and Jill's children will receive assets at the end of the GRAT (in further trust, or outright) equal to $505,372. And if the stock appreciates at a 15 percent rate during the trust term, the children will receive in excess of $2.1 million dollars, all for a gift value of slightly over $7,000.

Jack and Jill, during the trust term, will receive payments worth slightly over $293,000 annually in the form of cash (if there is cash to distribute) and/or property (ABC Co. stock).

If the stock does not appreciate in excess of the 7.6 percent benchmark rate of return, Jack and Jill will receive back all of the stock they put into the trust, and will have made a gift of $7,255 for which the family received no value.

The "explosion" in value represented by a typical IPO makes a GRAT an important planning technique to consider before the IPO occurs.

* The gift value is calculated incorporating such factors as the respective ages of the donor(s) and the likelihood that they will not survive the trust term.

Family limited partnerships

A family limited partnership can provide a way of transferring wealth to family members while maintaining control over the property. Under certain circumstances, it can also help the family avoid property transfer taxes. This form of partnership generally has two types of owners: a general partner and a limited partner. Generally, the donor, or a party with similar views as the donor, will act as the general partner while the heirs will be limited partners. The general partner or partners will maintain control over the assets with respect to vote, investment decisions, and liquidation. The heirs, as limited partners, will not participate in any of these decisions.

A family limited partnership can operate for an indefinite period of time, or it can be dissolved upon the expiration of the stated term, or upon the triggering of a certain event. When the partnership is dissolved, the partnership assets are distributed to the partners in proportion to their ownership interest. The distribution of these assets to the limited partners will not be treated as a taxable event to the limited partners. Thus, to the extent attributable to the limited partners, appreciation of the underlying property in the partnership will not be subject to additional gift and estate taxes. The use of a family limited partnership can also provide a discount upon the transfer of the property to the limited partnership for lack of marketability and/or lack of control (see discussion below on these discounts). In addition, use of a family limited partnership can provide a convenient way of transferring interests in property that are not readily divided, such as interests in real property.

With the advent of limited liability companies (LLC) across the nation, an LLC can be used in lieu of the family limited partnership in transferring interests in a closely held business to family members.

Discounts of minority interests and discounts for lack of marketability

The Internal Revenue Service has abandoned its former position that a minority interest in a business, which was valued for estate and gift tax purposes, is not entitled to a minority discount. Therefore, the general rule that gifts are valued for tax purposes at their full fair market value at the time of transfer will not be utilized for transfers of property into limited partnership or trust entities. These gifts will be valued for transfer tax purposes, at a discount from their full fair market value, to reflect the lack of voting power/control of the property. Additionally, discounts for lack of marketability of the property may also be utilized.

A minority interest discount is generally available in connection with the transfer of shares of a closely held corporation not representing a controlling interest. However, this discount is still available even if 100 percent of the stock of the corporation is transferred so long as minority stock ownership positions are transferred to each individual stock recipient. For example, a parent may transfer a 25 percent interest to each of his or her four children and reduce the value of it by an appropriate minority discount. The sum of the discounted values of these gifts could be substantially less than the value that would be received for the sale of 100 percent interest in the underlying company/property.

Traditionally, a company going public will experience an increase in its overall market value. Therefore, an owner of a closely held business may be able to take advantage of: the discounting of a gift of a minority interest; the discount for lack of marketability; and the subsequent appreciation of the property after the IPO. Advance planning in this area is critical to maximize the combination of the two discounts. If a lack of marketability discount is utilized in connection with the transfer of property closer to the IPO date, it may be difficult to support a significant combined discount, given that the IPO, and the pricing of the securities as a result of the IPO, may not indicate a significant lack of marketability.

S corporation's income tax planning

Termination of S corporation status

All public companies must be C corporations (i.e., a regular taxable corporation). Therefore, either prior to going public or as a result of an IPO transaction, an S corporation will terminate its S corporation status and become a C corporation. At the time the company terminates its S corporation status, the S tax year of the company will end. The next day, the company will begin a new tax year as a C corporation. At that time, the company and its shareholders must decide how to allocate the company's taxable income, deductions, and credits between the two tax years. A company may allocate these items between two short tax years, ratably based on the number of days in each, or elect to include all income accrued through the date of termination of S corporation status. This allocation choice will have significant tax consequences which should be planned for well in advance of the IPO. If more than 50 percent of the stock is sold during the tax year, a ratable allocation will not be available.

To illustrate the above, assume a calendar-year company, whose seasonal business profits are concentrated in the latter months of the year, converts to a C corporation in October. This company has the option of ratably "smoothing" the earnings between the S corporation and C corporation short tax years. If, however, greater than 50 percent of this company's stock were sold during the year, the company, upon conversion to a C corporation in October, would be required to reflect its earnings for the months October through December as earnings for the C corporation, possibly resulting in greater taxes being paid than would have been had the company been able to utilize the ratable allocation.

"Accumulated adjustments account" bail out

All S corporations have an accumulated adjustments account (AAA). This account contains the cumulative amount of S corporation undistributed income. This income has already been taxed because all income earned by an S corporation is taxed in the year in which it is earned whether or not it is distributed in that year. Going public often provides the funds necessary for distributing the balance of this account to the shareholders.

If the accumulated adjustments account is not distributed prior to the public offering, then the distribution can be made up to 12 months after the company's termination of its S corporation status. This distribution usually provides the shareholders of the S corporation with a significant amount of cash and tax savings. The tax savings made through distributions while a corporation holds an S corporation status, or made within the 12-month period after the termination of that status, will provide a federal tax benefit of approximately 40 percent. The table on the next page illustrates the savings.

Comparison of tax on distributed corporate earnings

	Distribution made after the 12 month period following the termination of S Corporation status	Distribution made after the 12 month period following the termination of S Corporation status
Accumulated adjustments account		
Balance upon termination of S corporation status	$1.00	$1.00
Individual tax (39.6%)[1]	(.40)	
Net cash after tax	$.60	$1.00
Federal tax rate on distributed	$.60	$1.00
Net cash after tax	$.60	$1.00
Federal tax rate on distribution corporate earnings	40%	0%

(1) Assumes maximum individual income tax rate and that all corporate income is distributed to shareholders.

If distributions are made after the 12-month period following the termination of S corporation status, the distributions are considered dividend income to the shareholders and taxed as such; if distributions out of the accumulated adjustments account are made within the 12-month period, they "escape" income treatment and no additional tax is paid.

It should also be noted that prior to terminating its S corporation status, a company should declare the distribution ("dividend") of the AAA so that only existing S corporation shareholders receive the distributions. A declaration after terminating S corporation status will result in the company having to distribute the AAA to all current shareholders, including new shareholders as a result of the IPO.

Personal financial planning

Asset allocation/diversification

The majority of a business owners' assets often consist of his or her ownership interest in the corporation. After the company goes public, whether it was an S corporation or C corporation, the shareholders of the company may find themselves with a significant amount of "paper" wealth. One of the benefits of going public is liquefying that investment. Conversion of a portion of your investment to a cash position provides an opportunity to diversify your assets by investing in any number of properties or financial instruments. Shareholders should take advantage of their ability to diversify their investment assets, and thus lessen their financial risk by spreading their wealth over a number of different types of investments.

Life insurance

Many corporations maintain life insurance policies on employee shareholders. When an S corporation goes public and converts to a C corporation, maintaining these life insurance policies may become unnecessary. At the time of conversion, these life insurance policies often have significant cash value. Terminating or exchanging these life insurance policies may cause significant tax consequences that should be planned for in advance (e.g., similar to pension plans, when the value of certain policies is received prematurely, a taxable event is triggered).

Pre-initial public offering tax planning for corporations

Net operating loss carryovers

Net operating losses are beneficial to the company in that they can usually be carried forward 15 years and carried back three years offsetting, to their full extent, income earned in those years. However, some of this benefit is lost if a company with a net operating loss goes public and the IPO results in an "ownership change."

"Ownership change" is a technical term defined by the Internal Revenue Code. Generally, it is defined as a change in ownership (during a three-year period) of greater than 50 percent. If an ownership change occurs, a company with a net operating loss will often be allowed to use only a fraction of its net operating loss to offset income in future years.

As a result of a company's possible forfeiture (upon going public) of the use of a net operating loss, tax planning — with regard to the full use of this net operating loss — should occur well in advance of the public offering.

International operations

If an S corporation has international sales, the company, upon conversion to a C corporation, should consider the creation of a foreign sales corporation. Foreign sales corporations are entities that can eliminate or defer corporate income taxes on a portion of the taxable income of regular C corporations. Traditionally, S corporations do not utilize these special tax benefit corporations, as they generally will not provide any tax benefits.

State and local planning

Many states have tax laws which may impact companies doing business therein, as well as the owners of such companies. While it is not possible to list all of the tax-planning opportunities, due to the variations in state tax laws, there often are significant tax-saving opportunities that can reduce the taxes of the company or individual owners, if properly planned in advance of the IPO.

Stock options and alternative compensation plans

Underwriters in the IPO process traditionally will examine the company's compensation approach with respect to its officers and other key employees. It is generally recommended that a compensation plan be put in place prior to when a company files its registration statement. There are many benefits to structuring a compensation scheme before a company goes public; however, the paramount consideration is that the existing owners select a long-term incentive plan which will reflect their management objectives.

The tax consequences to the company and the employee may vary among the various available plan structures. Consideration should be given as to when the plans become effective and when the employee rights vest. The early years of a public company are often critical with respect to its market price in the stock market; therefore, careful consideration should be given as to when stock options may vest or when the company is willing to accept a charge to its earnings for these bonus-type plans. It is important that these alternatives be examined thoroughly before any one plan or combination of plans is selected. See page 59 for a further discussion of compensation planning and design issues.

Change of accounting method for cash-basis taxpayers

If the company, after conversion to C corporation status, is an S corporation that uses the cash-basis accounting method, it must adopt the accrual-basis accounting method. The adoption of the accrual-basis accounting method will affect the tax liability of the company in future years. This method can affect the company negatively, or positively, depending upon the planning that was completed prior to adoption of the accrual method of accounting.

Conclusion

At this point you have the facts about what it takes to go public — the preparation, compliance and ongoing commitment. You have a good idea of the time it takes. You've looked at what the process is all about, evaluated the advantages and disadvantages, and weighed the costs. Practically speaking, you've begun to work through a process of strategic planning and analysis. You know what it takes to get your company looking and operating like a public company. You've also reviewed alternative methods of financing.

You have all the factual information you need to make an informed decision. But ultimately, the actual decision comes down to soul searching — to the examination and evaluation of your reasons for taking your company public and of how such a decision will affect your close personal relationships and the company itself. Are you considering going public solely to raise money? To expand the company? For status and prestige? Is going public necessary to attract and retain key people? Are you at the stage in life where you're looking for greater personal liquidity or a planned exit strategy?

The process can work for any of these reasons But remember, it takes time, careful preparation, and timing.

How PricewaterhouseCoopers can help

Whether your company is an emerging business seeking venture capital, or an established company seeking to expand through an initial public offering, you can rely on PricewaterhouseCoopers for a full range of support services. PricewaterhouseCoopers' global presence, extensive knowledge of capital markets, and network of financing relationships provides you the expertise and insight you need at every stage.

Our services reflect our approach to advising our clients that a well-conceived, planned, and executed strategy is needed from the very outset. PricewaterhouseCoopers' services span the complete life cycle of your capital market listing from the identification of an entry strategy through ongoing accounting support in dealing with the SEC.

Strategic planning

The right approach from the outset is needed to enter the securities markets in a way that will maximize your return and reflect the true strength of your business. To reap rewards and avoid the pitfalls, you need to have the right strategy.

In planning the best strategy for gaining access to the securities markets we:

— Provide strategic advice in the early planning stage to help management identify and evaluate the various alternative approaches for entering the public and private securities markets;

- Perform a preliminary study of the impact of complying with the SEC's financial reporting requirements — both from a burden of compliance and a sensitivity of disclosure standpoint — to identify any potential "deal breakers," offer practical solutions, and assess the magnitude of the task;
- Introduce the company to investment bankers, financial institutions, venture capitalists, and lawyers; and
- Assist in assessing the company's readiness for registered offering versus private placements.

Technical support

Once the strategy is established, we advise and guide the company's execution of the blueprint for success. Picking the right route through the rules, regulations, and interpretations is extremely complex and hazardous. In this area we:

- Assist in the identification and development of disclosures required in the footnotes to the financial statements, pro forma financial statements, and other separate financial statements required by SEC rules, regulatory agencies, and U.S. GAAP;
- Advise the company in developing OFR and other parts of the prospectus or offering circular;
- Help management address, negotiate, and resolve issues raised by the SEC in its review of the registration statement;
- Review the prospectus prior to filing to help the company comply with the technical requirements and minimize the number of SEC comments;
- Discuss issues with the SEC before the company files the registration statement;
- Anticipate SEC comments and help the company prepare responses to the comments; and
- Assist companies in requesting relief from the SEC where required information is not considered meaningful and is not cost effective to provide.

Project management support

Raising capital and the registration of securities can be complex and daunting and often impacts all aspects of your business. As a result, it will require direction by senior executives and involve resources from a wide array of organizational units. Good project management will be essential to achieving a level of success that could be vital to the market perception of your company.

We can help. Our team of project management professionals understands the dynamics and pressures of registration projects. We will tailor our level of support to meet your needs, ranging from periodic input throughout your planning and execution phases, to dedicating one of our highly-experienced project-management specialists to provide advice and counsel to the members of your project team.

Capitalizing on our extensive experience with registration projects, we have developed a structured approach to project management supported by robust principles and tools. This simple but effective framework provides a disciplined and consistent — but flexible — method of working, is adaptable for the needs, size, and culture of all companies. It is a tried and trusted way of managing business change that will help you to maintain a clear focus on the project objectives and an understanding of the way forward. Most importantly, it will enable you to "manage exception," confident that you have the means to control the project process and outcome with the minimum distraction from day-to-day business.

If you'd like to contact the nearest PricewaterhouseCoopers business advisory expert, please call our Hotline at 1-877-PwC-TICE or visit our Entrepreneur Resource Center at our VisionToReality site, www.pwcV2R.com and click on "Consult a Professional."

Appendices

The following three sections provide additional background and reference material that may be of interest as you consider the going-public decision. These appendices provide additional regulatory information, more details on the going-public process, and a glossary of terms found throughout this publication and commonly used in IPO discussions.

Appendix A – The SEC and security regulations

The SEC is the principal regulatory authority over the offering and trading of securities, whose overriding objective is the protection of investors and the maintenance of fair and orderly markets. It reviews, and may reject, registration statements for new securities issues and supervises the day-to-day operation of the securities markets. It is important to note that the responsibility of the SEC is to protect the investing public — not the issuer, the underwriters, or the securities brokers and dealers.

The SEC was created by the Securities Exchange Act of 1934 and is responsible for administering the provisions of that Act, as well as the Securities Act of 1933.

The Securities Act of 1933

The Securities Act of 1933 (1933 Act) requires the registration of securities with the SEC prior to their sale to the public. It is a disclosure statute designed to protect prospective investors from misrepresentation, manipulation, and other fraudulent practices in connection with the public offering of a company's securities.

Disclosure is provided by means of a registration statement. A copy of a prospectus, which forms part of the registration statement, must be furnished to each person who buys stock in an offering or who requests it in writing. A company's 1933 Act registration statement is a public document available for inspection by any person, and may be obtained by accessing the SEC's EDGAR database on its Internet Web site (http://www.sec.gov). However, in certain situations, portions of the document may be accorded confidential treatment.

Registration statements that fall under the 1933 Act include (but are not limited to) the list that follows:

— Forms S-1, SB-1, and SB-2 – These forms are typically used by companies that are first-time registrants of securities to be sold to the public.

— Forms S-2, S-3, and S-4 – These forms are typically used by companies that have been subject to SEC reporting requirements for one year or longer, i.e., existing SEC registrants that are registering additional securities.

— "F" series forms (e.g., Form F-1) – These forms are used by foreign entities wishing to register securities in the U.S.

All registrants making an offering of securities are subject to the antifraud provisions of the 1933 Act. These provisions impose civil and criminal liabilities for untrue statements or omissions, and apply not only to controlling shareholders, directors, and underwriters but also to the accountants and lawyers who assist in the preparation of a registration statement and are named therein.

The Securities Exchange Act of 1934

In contrast to the 1933 Act, which is primarily concerned with the initial distribution of securities, the Securities Exchange Act of 1934 (1934 Act) addresses periodic reporting obligations for issuers with publicly held securities. Generally, the 1934 Act registration statements and reports are intended to assist a person in reaching an informed opinion regarding a company's securities.

The principal objective of the 1934 Act is the regular dissemination of significant financial and other information relating to securities traded on the national securities exchanges or marketplaces. This is accomplished by requiring registrants to file annual, quarterly, and other periodic reports. These reporting obligations may be automatically suspended for companies that have (1) less than 300 shareholders or (2) less than 500 shareholders and total assets of less than $10 million after the end of each year for the past three years. For new public companies, this immediate suspension is not available for the year in which the IPO registration statement becomes effective.

The 1934 Act also includes other protective regulations, including rules that prohibit insider trading and securities market manipulations (which give a false or misleading appearance of active trading). There are also requirements for corporate insiders (directors and officers of registered corporations and principal owners of their equity securities) to file statements of their equity securities holdings and monthly reports of changes in such holdings. The market generally shows a keen interest in insider trading activity.

The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002 and represents the most significant reform in securities laws since they were first enacted. Written in response to high-profile corporate scandals, the purpose of SOA is to restore confidence in public financial reporting by prescribing fundamental changes in how audit committees, management, and auditors interact and carry out their responsibilities.

The Public Company Accounting Oversight Board (PCAOB) was established by the SOA to oversee the audit of public companies that are subject to U.S. securities laws. The duties of the PCAOB, as established by the Act, include establishing audit, quality control, and independence standards; registering public accounting firms; inspecting public accounting firms; and conducting investigations and disciplinary proceedings. The PCAOB, subject to the oversight of the Securities and Exchange Commission, replaced the accounting profession's self-regulating framework.

Presented below are some of the key elements of Sarbanes-Oxley that impact issuers:

Management certifications and report on internal control

Section 302 – This Section requires an issuer's principal executive and financial officers each to certify the financial and other information contained in the issuer's quarterly and annual reports. The rules also require these officers to certify that: they are responsible for establishing, maintaining, and regularly evaluating the effectiveness of the issuer's internal controls; they have made certain disclosures to the issuer's auditors and the audit committee of the board of directors about

the issuer's internal controls; and they have included information in the issuer's quarterly and annual reports about their evaluation and whether there have been significant changes in the issuer's internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation. This Section also requires issuers to maintain and regularly evaluate the effectiveness of disclosure controls and procedures designed to ensure that the information required in reports filed is recorded, processed, summarized, and reported on a timely basis.

Section 906 – This Section contains a certification requirement that is separate and distinct from the certification requirement mandated by Section 302. Section 906 provides that each periodic report containing financial statements filed by an issuer with the Commission pursuant to Section 13(a) or 15(d) of the Exchange Act must be accompanied by a written statement by the issuer's chief executive officer and chief financial officer (or the equivalent thereof) certifying that the report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the issuer. Section 906 expressly creates new criminal penalties for a knowingly or wilfully false certification.

Section 404 – This Section requires issuers, other than registered investment companies, to include in their annual report a report of management on the company's internal control over financial reporting. The internal control report must include: a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company; management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year; a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and a statement that the registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting. Under the rules, a company is required to file the registered public accounting firm's attestation report as part of the annual report. Section 404 is effective for fiscal years ending on or after November 15, 2004 for issuers classified as accelerated filers and July 15, 2005 for other issuers.

Audit committees

Section 301 – Requirements relate to: the independence of audit committee members; the audit committee's responsibility to select and oversee the issuer's independent accountant; procedures for handling complaints regarding the issuer's accounting practices; the authority of the audit committee to engage advisors; and funding for the independent auditor and any outside advisors engaged by the audit committee.

Section 407 – The rules require a company to disclose whether it has at least one "audit committee financial expert" serving on its audit committee, and if so, the name of the expert and whether the expert is independent of management.

A company that does not have an audit committee financial expert must disclose this fact and explain why it has no such expert.

Independent auditors

Section 201 – Prohibits a registered public accounting firm from providing any non-audit service to an issuer contemporaneously with the audit that includes: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation services; (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (4) actuarial services; (5) internal audit outsourcing services; (6) management functions or human resources; (7) broker or dealer, investment adviser, or investment banking services; (8) legal services and expert services unrelated to the audit; (9) any other service that the Board determines, by regulation, is impermissible. The Board may, on a case-by-case basis, exempt from these prohibitions any person, issuer, public accounting firm, or transaction, subject to review by the Commission. It will not be unlawful to provide other non-audit services if they are pre-approved by the audit committee in the following manner. The bill allows an accounting firm to "engage in any non-audit service, including tax services," that is not listed above, only if the activity is pre-approved by the audit committee of the issuer. The audit committee will disclose to investors in periodic reports its decision to pre-approve non-audit services. Statutory insurance company regulatory audits are treated as an audit service, and thus do not require pre-approval. The pre-approval requirement is waived with respect to the provision of non-audit services for an issuer if the aggregate amount of all such non-audit services provided to the issuer constitutes less than five percent of the total amount of revenues paid by the issuer to its auditor (calculated on the basis of revenues paid by the issuer during the fiscal year when the non-audit services are performed); if such services were not recognized by the issuer at the time of the engagement to be non-audit services; and if such services are promptly brought to the attention of the audit committee and approved prior to completion of the audit. The authority to pre-approve services can be delegated to one or more members of the audit committee, but any decision by the delegate must be presented to the full audit committee.

Section 204 – The accounting firm must report to the audit committee all "critical accounting policies and practices to be used, all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred" by the firm.

Other

Section 304 – If an issuer is required to prepare a restatement due to "material non-compliance" with financial reporting requirements, the chief executive officer and the chief financial officer shall "reimburse the issuer for any bonus or other incentive-based or equity-based compensation received" during the twelve months following the issuance or filing of the non-compliant document and "any profits realized from the sale of securities of the issuer" during that period. In any action brought by the SEC for violation of the securities laws, federal courts are authorized to "grant any equitable relief that may be appropriate or necessary for the benefit of investors."

Section 402 – Generally, it will be unlawful for an issuer to extend credit to any director or executive officer. Consumer credit companies may make home improvement and consumer credit loans and issue credit cards to its directors and executive officers if it is done in the ordinary course of business on the same terms and conditions made to the general public.

State securities legislation

In addition to Federal regulations, individual states have their own securities laws known as "Blue Sky" laws. These vary in content, and some disallow offerings that are not "fair, just or equitable." In some states, the prospectus and registration statement filed with the SEC fulfills the state registration requirements; in other states, additional information is required. Accordingly, when offering securities, a company must carefully consider state regulations. The need to obtain clearance in key states is important since failure to do so can impede the initial distribution of your stock.

Securities markets

The two major securities markets in the U.S. are the New York Stock Exchange (NYSE) and the NASDAQ Stock Market (NASDAQ). In addition, there are numerous regional exchanges.

New York Stock Exchange – The NYSE is also known as the Big Board. The NYSE is an "exchange," which means that shares are auctioned on a trading floor by specialists responsible for all of that stock's activity. All orders go through the specialist who matches orders for buyers and sellers. The NYSE lists more than 2,800 companies.

The NASDAQ Stock Market – Consists of the NASDAQ National Market and The NASDAQ Small Cap Market, which includes listings for over 5,000 companies. NASDAQ is a stock "market," meaning that trading is done electronically through computer transactions and telephone conversations (i.e., there is no physical location). NASDAQ stocks are traded by "market makers," who, often using their own money, work together to make a market for a given stock. The NASDAQ tends to provide a more liquid market since the combined capital of a number of market makers usually exceeds the funds available to a specialist on an exchange.

Other markets

Additionally, there are other over-the-counter (OTC) services for smaller securities, which, based upon their size, may or may not be subject to SEC reporting requirements. These include pink sheets and the OTC Bulletin Board.

Listing criteria for the major markets

The listing criteria for the major exchanges may be found on their Web sites:

www.nasdaq.com
www.nyse.com

Appendix B – Detailed going-public timetable

The timetable below covers a period of 120 days. While it is convenient to refer to the IPO process as taking place in 100 days, it often takes longer. Thus, the timetable below may be a more accurate representation. There are many factors impacting the timetable, but one of the more important factors is the availability of audited financial statements by day 35.

Day	Activity	Responsibility
<0	Select underwriter; Sign letter of intent; Quiet period begins	Management
1	Hold board of directors' meeting to authorize: — Issuing additional shares — Preparing registration statement for filing with SEC — Negotiating underwriting agreement — Engaging professionals	Management
2	Hold initial organizational meeting ("all hands" meeting) of the going-public team to determine: — Type and structure of the offering — Offering timetable and responsibilities — Form and format of registration statement	Team
3	Commence due-diligence review	Underwriter and its counsel
4	Assign responsibilities and complete timetable; Distribute timetable to all team members	Team
5	Begin drafting registration statement: — Textual information — Financial statements and pro forma information	Management and its counsel; Management and independent accountant
12	Prepare draft of underwriting agreement, agreement among underwriters, and Blue Sky survey (see Glossary, page 89)	Management and its counsel; Underwriter's counsel
15	Distribute questionnaires to directors, officers, and selling shareholders related to registration statement	Management, underwriter, and respective counsel

Day	Activity	Responsibility
20	Complete review of corporate legal documents	Management and its counsel
30	Review first draft of textual portion of registration statement	Team
35	Complete and submit draft of financial statements for inclusion in registration statement	Management and independent accountant
45	Review draft of registration statement, including financial statements	Team
50	Appoint stock transfer agent and registrar and arrange for preparation of stock certificates	Management
	Discuss comfort letter requirements and procedures	Management, underwriter, and independent accountant
60	Send first draft of registration statement to printer	Management
70	Hold board of directors' meeting to approve and sign registration statement	Management and its counsel
71	File registration statement with the SEC, NASD, and states	Management and its counsel
101	Receive comment letter from SEC regarding registration statement. Note, 30 days is the minimum time to expect for SEC review. It is quite common for the review to take 45 days or more. All activities that follow will occur later based on timing of SEC comments.	Management and its counsel
102	Hold meeting to review and discuss SEC comment letter	Team
103-105	Prepare amendments to registration statement resulting from the SEC's comment letter and send draft to printer	Team

Day	Activity	Responsibility
106	Review printer's proof of amendments to registration statement	Team
	Print and distribute preliminary prospectus ("red herring") to the proposed underwriting syndicate	Underwriter
	Send draft comfort letter to underwriter	Independent accountant
	Publish tombstone ad	Management and underwriter
	Begin road show	Management, PR firm, and underwriter
114	Hold due-diligence meeting to respond to questions from the underwriting group	Underwriter, with team participation
115	Finalize offering price	Management and underwriter
116	Deliver first comfort letter to underwriter	Independent accountant
	Sign underwriting agreement	Management, underwriter, and respective counsel
	File price amendment to registration statement (alternatively, amend the final prospectus for this information and incorporate by reference into the registration statement)	Management and its counsel
	Notify stock exchange and NASD of effectiveness and start to trade	Management's counsel
121	Deliver second comfort letter to underwriter	Independent accountant
	Complete settlement with underwriter; Issue stock; Collect proceeds from offering; Sign all final documents	Management, underwriter, and respective counsel
	Issue press release	Management, PR firm, and underwriter

Appendix C – Glossary

1933 ACT See SECURITIES ACT OF 1933.

1934 ACT See SECURITIES EXCHANGE ACT OF 1934.

ACCELERATED FILER Domestic reporting companies that have a public float of at least $75 million, that have been subject to the Exchange Act's reporting requirements for at least 12 calendar months, and that previously have filed at least one annual report.

ACCELERATION REQUEST A request to the SEC to waive the statutory 20-day waiting period and declare the registration statement effective at an earlier date.

ACCOUNTING PRINCIPLES BOARD OPINIONS (APB) Opinions issued by the Accounting Principles Board that establish accounting and reporting standards. This Board is the predecessor to the FASB.

ACCREDITED INVESTOR Potential investors who meet certain minimum net worth and income tests (as determined by the SEC) as they relate to certain exempt offerings. See also SOPHISTICATED INVESTOR, and consult with your legal counsel for further clarification.

AGREEMENT AMONG UNDERWRITERS An agreement among the members of the underwriting group/syndicate that specifies, among other things, the managing underwriter and the terms of the underwriting.

ALL HANDS MEETING A meeting that occurs during preparation for an IPO that is attended by company representatives, company counsel, the independent accountants, underwriters, and underwriters' counsel.

ALL-OR-NONE A specific type of a best efforts underwriting: If the underwriter is not able to sell all of the shares being offered, none of the shares will be offered, and the offering will be canceled.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA) The organization that governs and disciplines the conduct of certified public accountants and establishes standards for the profession.

ANALYST An individual, usually employed by an investment banking firm, who studies and analyzes an industry and the publicly held companies operating within the industry for the purpose of providing investment advice.

ANTIDILUTIVE SECURITIES Securities whose assumed exercise would create an increase in earnings per share or a reduction in net loss per share; these securities are generally excluded from the computation of earnings per share.

BEST EFFORTS OFFERING An underwriting agreement where the underwriters use their best efforts to sell the stock; however, the underwriters have no obligation to purchase stock not purchased by investors.

BID AND ASK The quoted prices of securities traded in the over-the-counter market. The bid price is the highest price a buyer is willing to offer, while the ask price is the lowest price a seller is willing to accept. The difference between the bid and ask prices is known as the "spread."

BLUE SKY LAWS The name applied to the securities laws of various states enacted to protect investors. While the SEC regulations are national in application, various states have securities laws that affect public offerings.

BLUE SKY MEMORANDUM A memorandum setting forth the various securities law provisions and restrictions applicable to each of the states in which the offering is to be made. The memorandum is usually prepared by legal counsel.

BOOK VALUE PER SHARE A share of stock's equity value, computed by dividing a company's net worth (assets minus liabilities) by the number of shares outstanding.

BOOK VALUE STOCK PLANS Plans in which restricted stock (or options) is sold to employees based on book value and the company buys back the stock (or options or shares received upon exercise of the options) at a later date, usually at its then net book value.

BROKER A commonly used term applied to individuals or firms that trade securities. Brokers execute trades of securities between buyers and sellers in return for a fee or commission. Brokers do not own the securities in which they trade and, accordingly, do not share in the risks or rewards of ownership.

CAPITALIZATION The total amount of a company's outstanding securities. For purposes of display in a registration statement, capitalization includes short-term debt, long-term debt, and equity securities.

CAPITALIZATION TABLE A table presenting the capital structure of the company, both prior to the offering and assuming that all securities offered are sold.

CARVED-OUT ENTITY A subsidiary, division, or lesser business component that is separated from another entity. This carved-out entity may become a separate registrant through an IPO.

CHEAP STOCK Common stock, stock options, warrants, or other potentially dilutive instruments issued to employees, consultants, directors, promoters, or others providing services to an issuer at a price lower than the public offering price.

CLOSELY HELD COMPANY A company where the equity interests are held by a few individuals or group of individuals.

CLOSING The final meeting of the going-public process in which the company delivers its registered securities to the underwriter and receives payment for the issue. The closing is usually five to seven days after the effective date of the registration statement.

CO-MANAGER In an underwriting, if there is a second (or third) managing underwriter representing the syndicate, that securities firm will be known as a "co-manager."

COMFORT LETTER A letter written by independent accountants to the underwriter as part of the underwriter's due-diligence reviews. The letter discusses the results of agreed-upon procedures applied to the company's financial data, as requested by the underwriters. Comfort letters provide "negative assurance" to the underwriter and are not included in the registration statement.

COMMENT LETTER A letter written by the SEC's review staff that requests modification to the registration statement or the inclusion of additional information.

CONFORMED COPY A registration statement or other document displaying signatures that are printed or typed rather than signed manually. All EDGAR documents are conformed copies. However, each signatory to that electronic filing also must manually sign a signature page acknowledging the signature that appears in typed form within the electronic filing. The manual signature is executed before or at the time the electronic filing is made.

CONSENT A document giving consent to the use of an independent accountant's or other expert's report and name in the registration statement. A conformed document is filed with the registration statement, while a manually signed copy is kept by the registrant.

CONTROL STOCK Limited transferability stock owned by individuals who control the company.

CONVERTIBLE SECURITIES Corporate securities (usually preferred stock or bonds) that are exchangeable into a fixed number of shares of common stock at a stipulated price.

COOLING-OFF PERIOD See WAITING PERIOD.

DEALER A commonly used term applied to those individuals or firms that trade securities. Dealers trade securities for others and for their own account. Dealers may own the traded securities and thus are subject to the risks and rewards of ownership.

DERIVATIVES Financial instruments whose value is based on another security, commodity, or index.

DILUTION A reduction in a shareholder's relative ownership percentage of a company or the company's earnings per share (EPS) as a result of the company's issuance of more shares. Dilution in an IPO results from a disparity between the IPO price and the net book value of tangible assets for existing shares and is usually reflected in the registration statement in tabular format, referred to as a dilution table.

DILUTIVE SECURITIES Securities whose issuance or exercise would decrease earnings per share.

DIRECTORS'/OFFICERS' QUESTIONNAIRES Questionnaires circulated by the company's and underwriter's counsel during the registration process. The questionnaires gather and confirm various data that must be disclosed in the registration statement.

DISSOLUTION The process of liquidating a partnership or a corporation.

DIVISION OF CORPORATION FINANCE A division of the SEC which, among other things, reviews registration statements filed with the SEC.

DUE DILIGENCE A reasonable investigation conducted by the company's officers and directors, underwriters, and lawyers to provide a reasonable ground for belief that, as of the effective date, the registration statement contains no significant untrue or misleading information and that no material information has been omitted.

EARN-OUT ARRANGEMENTS Arrangements in a business acquisition in which sellers receive additional future consideration for their security interests usually based on future earnings.

EARNINGS PER SHARE (EPS) A company's net income, generally divided by the number of its common shares outstanding, and adjusted for certain dilutive securities such as stock options, warrants, and convertible debt.

EFFECTIVE DATE The date the SEC allows the registration statement to become effective and the sale of securities may commence.

ELECTRONIC DATA GATHERING, ANALYSIS, AND RETRIEVAL (EDGAR) SYSTEM The SEC's electronic system for filing registration statements and periodic reports under the 1933 and 1934 Acts.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP) A plan instituted by a company that gives stock to its employees. The primary purpose of such a plan is to attract and retain good officers and employees.

EQUITY METHOD Method of accounting in which the investor records an investment in the stock of an investee at cost and adjusts the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of acquisition (generally applies to investments where stock ownership is between 20 and 50 percent of the outstanding securities of the investee).

ESCROW ACCOUNT An account in which the offering proceeds are kept prior to closing, usually in a best efforts underwriting.

EXEMPT OFFERING A securities offering that does not require a registration statement to be filed with the SEC. Exempt offerings include Regulations A and D and intrastate offerings.

EXPERTS Independent accountants, engineers, or others whose proficiency in a specific area qualify them as specialists in their fields.

F-SERIES FORMS Forms used by foreign companies to comply with the 1933 and 1934 Acts. Examples include (1) Forms F-1 through F-10, registration statements similar to Forms S-1 through S-4, and Forms SB-1 and SB-2, and (2) Form 20-F, an annual report similar to Form 10-K.

FAMILY LIMITED PARTNERSHIPS A partnership set up to transfer wealth to family members while maintaining control over the income-producing property. The donor would generally be the general partner while the heirs would be the limited partners. The general partners maintain control over the assets with respect to voting, investment decisions, and liquidation, while the limited partners will not participate in these decisions. Establishment of family limited partnerships can be used as a tax strategy to distribute assets to family members without triggering a taxable event.

FIDUCIARY LAWS Laws that require transactions between a company and its officers, directors, or large shareholders to be fair to the company. These laws apply to privately held as well as publicly held companies.

FINAL PROSPECTUS A document that must be circulated to all purchasers of stock disclosing material facts about the company's operations, its financial status, and the details of the offering. It is often preceded by a preliminary prospectus, also known as a red herring.

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) A private body that establishes financial accounting and reporting standards in the United States.

FINANCIAL PRINTER A printer that specializes in the printing of financial documents, including registration statements, prospectuses, and proxy statements. These printers are also capable of converting your documents to an EDGAR format and electronically submitting the document to the SEC.

FINANCIAL REPORTING RELEASES (FRRs) Releases designed to communicate the SEC's positions on accounting principles and auditing practices.

FIRM COMMITMENT UNDERWRITING A type of offering in which the underwriter agrees to purchase all of the shares being offered regardless of whether investors purchase the shares. Any shares not sold to the public are paid for and held by the underwriters for their own account.

FOREIGN CORRUPT PRACTICES ACT (FCPA) An amendment to the 1934 Act that requires reporting companies to keep adequate accounting records, maintain adequate internal accounting control systems, and not make certain payments to specified foreign officials and politicians.

FOREIGN SALES CORPORATION Entities recognized by the Internal Revenue Code that may eliminate or defer payment of U.S. corporate income taxes on a portion of the income generated from export sales.

FORM 8-K A form required to be filed with the SEC when certain significant reportable events occur (e.g., major acquisitions or legal proceedings).

FORM 10-K An annual report required to be filed with the SEC pursuant to the 1934 Act. Form 10-K includes annual financial statements, related schedules, and various textual information.

FORM 10-KSB An annual report form required by the 1934 Act that may be filed with the SEC by small business issuers under Regulation S-B.

FORM 10-Q A quarterly report required to be filed with the SEC pursuant to the 1934 Act; consists primarily of the company's quarterly financial statements.

FORM 10-QSB A quarterly report required by the 1934 Act that may be filed with the SEC by small business issuers under Regulation S-B.

FORM S-1 The most common form of registration statement used in the initial public offering of securities by issuers for which no other form is authorized or prescribed.

FORM S-2 The registration statement used by companies that have been subject to the 1934 Act reporting requirements for at least 36 months and which combines incorporation by reference with delivery of the annual shareholder report and interim reports.

FORM S-3 A short-form registration statement available to companies that have been subject to the 1934 Act reporting requirements for at least 12 months and that meet certain market value or debt-rating tests. This registration statement also permits incorporation by reference, but does not require delivery, of the latest annual report to investors.

FORM S-4 The registration form used to register shares offered in connection with business combinations (e.g., mergers, consolidations, exchange offers for securities of another entity).

FORM SB-1 The registration form available to small business issuers to register up to $10 million of securities, to be sold for cash, in any continuous 12-month period.

FORM SB-2 The registration form available to small business issuers to register securities to be sold to the public for cash. This form differs from Form SB-1 in that there is no limitation on the amount that can be raised in the offering.

FORM SR A report required to be filed with the SEC after an IPO that describes the use of the offering proceeds.

GIFT TAX EXCLUSION An annual exclusion granted by the Internal Revenue Service that allows a donor to give up to $10,000 per year to an unlimited number of donees without incurring gift taxes.

GOING PUBLIC The process of a privately owned company selling its ownership shares to the investing public. See INITIAL PUBLIC OFFERING.

GRANTOR RETAINED ANNUITY TRUST (GRAT) An irrevocable trust that provides an effective way to reduce gift tax on property while providing an income annuity to the grantor. At the termination of the trust, the trust principal is paid to the beneficiary of the trust. A GRAT allows the grantor to retain control while retaining income from the property granted. A GRAT works particularly well with appreciated property/stock.

GREEN-SHOE OPTION/OVERALLOTMENT OPTION An option contained in the underwriting agreement that allows the underwriter to purchase and sell additional shares if the market's demand for the shares is greater than originally expected.

GROSS PROCEEDS The total dollar amount raised through an initial public offering, before deduction of discounts or commissions for underwriters and expenses for legal, auditing, printing, filing, and Blue Sky laws.

IN REGISTRATION The status of a company that has filed a registration statement with the SEC prior to the date the SEC declares the registration statement effective.

INCORPORATION BY REFERENCE Certain materials previously filed with the SEC which may, under certain conditions, be referred to rather than included in the text of subsequently filed documents.

INDUSTRY GUIDES Guides followed by the SEC staff requiring the disclosure of policies and practices by certain industries.

INDUSTRY POP/INDUSTRY FLURRY An industry where there has been a significant number of successful IPOs. Generally, in that industry, there may be many "me too" companies trying to follow the leaders.

INITIAL PUBLIC OFFERING (IPO) The offering or sale of a company's securities to the investing public for the first time (i.e., converting a company from private to public ownership).

INSIDER TRADING The sale or purchase of a company's securities by directors, officers, and others. See INSIDERS.

INSIDERS Individuals that may have access to nonpublic information, e.g., officers, directors, and major shareholders.

INSTITUTIONAL INVESTORS Nonindividual shareholders. Institutional investors include pension funds, mutual funds, and trusts.

INTERIM FINANCIAL STATEMENTS See STUB-PERIOD FINANCIAL INFORMATION.

INTRASTATE OFFERING A securities offering limited to investors residing in the state in which the issuer is doing a significant portion of its business. Such offerings are usually exempt from registration with the SEC.

INVESTMENT BANKER A person or (usually) a firm that, among other things, underwrites securities, functions as a broker/dealer, and performs corporate finance and merger and acquisition advisory services. Investment bankers are usually full-service firms that perform a range of services, as opposed to an underwriter or broker/dealer, which only provides one specific service.

IPO BACKLOG The number of companies that have filed initial registration statements with the SEC but whose registration statements are not yet effective. Also, an estimate of the gross offering amount of those companies.

ISSUE A block of securities sold to investors by a company through an offering.

ISSUER A company offering its securities for sale.

JOINT VENTURE An arrangement whereby two or more parties (the venturers) jointly control a specific business undertaking and contribute resources towards its accomplishment.

LEGENDED STOCK See RESTRICTED STOCK.

LETTER OF INTENT A nonbinding letter from the underwriter to the company that sets forth the general terms and conditions of the securities offering.

LETTERED STOCK See RESTRICTED STOCK.

LEVERAGED BUYOUT An acquisition of a company financed largely by debt.

LIMITED OFFERING An offering of securities exempt from registration due to exemptions for the size of offering and the number of purchasers.

LISTING APPLICATION A document, similar in nature to a registration statement, formally requesting that an issuer's securities be listed on a national securities exchange.

LOCK-UP PERIOD Usually appears as a provision in the underwriting agreement. Represents the period of time after an IPO during which (at the underwriter's request) insiders are prohibited from selling their shares. This period can range from a few months to several years.

MAKING A MARKET The process by which a securities dealer supports the trading activity of a particular security. The process may include the dealer purchasing and selling the security in order to balance the market. Such dealers are referred to as "market makers."

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) A textual discussion and analysis of a registrant's liquidity, capital resources, and results of operations that must be prepared by management and included in registration statements and most 1934 Act reports.

MANAGING UNDERWRITER In a syndicate of underwriters, the managing or lead underwriter functions as the primary decision maker.

MARKET MAKER An underwriting firm that stands ready to buy and sell a company's stock and thus make a market where shareholders or prospective shareholders can dispose of or purchase shares.

MERGERS A business combination where one entity becomes a part of another entity.

MINORITY INTEREST DISCOUNT For tax purposes, a minority interest discount represents a discounted amount from the fair market value of property or securities transferred to minority interests due to lack of voting power/control.

MINORITY INTEREST An individual or aggregate interest held in an entity that is generally less than 50 percent of outstanding voting securities.

NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD) An independent, self-governing association of securities brokers and dealers that helps to govern, among other things, its members and the over-the-counter stock market.

NATIONAL ASSOCIATION OF SECURITIES DEALERS AUTOMATED QUOTATION SYSTEM (NASDAQ) The NASDAQ is the electronic trading system in the over-the-counter (OTC) market. Unlike the New York Stock Exchange (NYSE), the NASDAQ is not physically located in one location.

NEW ISSUE An initial public offering, or an issue of securities by a corporation (also known as a primary offering).

NEW YORK STOCK EXCHANGE (NYSE) One of the major stock exchanges. See Appendix A for the listing criteria.

"NO ACTION" LETTER A letter issued by the SEC stipulating that it does not object to a course of action proposed by a registrant. "No action" letters are generally issued after a request has been made by a registrant.

NONACCREDITED INVESTOR Investors that do not meet the accredited investor criteria. See ACCREDITED INVESTOR.

OFFERING CIRCULAR Sometimes referred to as a private offering memorandum. A document used in certain securities offerings that are exempt from SEC registration requirements.

OPTIONS A security giving its owner the right to purchase or sell a company's shares at a fixed date and agreed-upon price.

OVER-THE-COUNTER MARKET (OTC) A market for the exchange of stocks not traded on a listed exchange, maintained by dealers. See also NATIONAL ASSOCIATION OF SECURITIES DEALERS.

OVERALLOTMENT OPTION The sale of shares by the underwriter in excess of those shares initially available. See also GREEN-SHOE OPTION.

OWNERSHIP CHANGE A term defined in the Internal Revenue Code. Generally, it is defined as a change in ownership of a corporation during a three-year period of greater than 50 percent, which results in limitations on the ability of the corporation to utilize pre-ownership change net operating losses.

PERFORMANCE SHARE PLANS Incentive compensation plans, whereby the number of shares to be issued to employees is determined by a formula based on the achievement of predetermined performance criteria (e.g., increases in earnings per share, increases in return on equity, or growth in sales).

PERFORMANCE UNITS PLANS These plans provide for the award of units to employees, where each unit entitles an employee to receive in cash or stock a certain amount if certain performance criteria (e.g., sales growth, increases in earnings per share, or return on equity) are attained during the period specified by the award.

PHANTOM STOCK PLANS Incentive compensation plans whereby hypothetical (phantom) shares are granted to employees, which entitles the employees to receive amounts based on the increase in the market price of the stock from the date of grant. Some phantom stock plans also provide for dividend equivalents, i.e., employees will receive amounts equal to dividends declared on the stock. Also known as Stock Appreciation Rights (SAR).

POST-EFFECTIVE AMENDMENT A registration statement amendment filed subsequent to the effective date of registration.

PREFILING CONFERENCE A conference with the SEC usually attended by a company's principal financial officer together with representatives from the company's independent accounting firm to discuss unique accounting issues prior to the SEC's registration review process.

PRELIMINARY PROSPECTUS A document that provides information concerning a forthcoming issue of stock. Also known as a red herring.

PRICE AMENDMENT Usually the final amendment to a registration statement; includes the offering price and final pro forma financial information.

PRICE EARNINGS RATIO A measurement of common stock value computed as the price per share divided by earnings per share.

PRICE RANGE A proposed price-per-share range is often printed on the cover page of a preliminary prospectus. Example: "It is estimated that the offering price will be $8 to $10 per share."

PRIMARY OFFERING An offering in which all of the proceeds from the sale of previously unissued stock are received directly by the company.

PRIVATE PLACEMENT An offering that is exempt from the requirements of registration and is limited in distribution.

PRO FORMA Financial statements or financial tables prepared as though certain transactions had already occurred. For example, a registration statement might include a pro forma balance sheet that reflects the anticipated results of the offering.

PROSPECTUS The primary selling document in an offering distributed to potential investors. The prospectus provides information about the company and the offering. See also PRELIMINARY PROSPECTUS and FINAL PROSPECTUS.

PROXY A document prepared for a shareholder to authorize another person to act on his/her behalf at a shareholders' meeting.

PROXY SOLICITATION The request to be authorized to vote on someone else's behalf. A proxy statement must be provided to shareholders prior to soliciting their proxies.

PROXY STATEMENT An SEC-required statement of information to be furnished to shareholders by those individuals soliciting shareholder proxies.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB) An organization established by the Sarbanes-Oxley Act to oversee the audit of public companies that are subject to U.S. securities laws. The duties of the PCAOB, as established by the Act, include establishing audit, quality control, and independence standards; registering public accounting firms; inspecting public accounting firms; and conducting investigations and disciplinary proceedings. The PCAOB, subject to the oversight of the Securities and Exchange Commission, replaced the accounting profession's self-regulating framework.

PUBLIC FLOAT The aggregate market value of voting common stock held by nonaffiliates.

QUALIFIED INSTITUTIONAL BUYER (QIB) A nonindividual shareholder that owns and manages at least $100 million in securities, with certain exemptions for broker-dealers, banks, and savings and loan associations.

QUIET FILING See SILENT FILING.

QUIET PERIOD The period which begins on the date an offering commences (usually once the company and its underwriter reach a preliminary understanding) and generally ends 90 days following the effective date of the registration statement. Referred to as the quiet period because of the SEC's restrictions on publicity about the company and/or its offering.

RED HERRING The preliminary prospectus circulated during the waiting period to potential investors. Commonly referred to as a red herring because the disclaimer, at one time, was required to be printed in red ink.

REGISTRANT An entity that must file reports with the SEC.

REGISTRAR An agent, usually a bank, that physically issues, transfers, and cancels stock certificates as stock transactions occur.

REGISTRATION PERIOD The time from which a registration statement is filed with the SEC to the day the SEC allows the registration statement to be declared effective.

REGISTRATION STATEMENT The primary document required to be filed with the SEC in connection with the issuance of securities. Required by the Securities Act of 1933, a registrant generally uses Form S-1, SB-1, or SB-2 for an initial public offering.

REGULATION A Provisions of the 1933 Act that contain the rules governing certain public offerings of no more than $5,000,000 which are exempt from registration.

REGULATION D Provisions of the Securities Act of 1993 that contain the rules for certain private placement offerings.

REGULATION S-B Specifies the form and content of financial statements as well as the disclosure requirements for the nonfinancial statement portion of filings to be filed with the SEC by small business issuers. It is an integrated and simplified version of Regulations S-K and S-X.

REGULATION S-K Contains the disclosure requirements for the nonfinancial statement portion of filings with the SEC.

REGULATION S-T Governs the preparation and submission of documents filed via the SEC's EDGAR system.

REGULATION S-X Specifies the financial statements to be included in filings with the SEC and provides rules and guidance on their form and content.

RESTRICTED STOCK Securities, usually issued in private placements, that have limited transferability. Also called legended stock or lettered stock.

ROAD SHOW A presentation to potential investors, brokers, and dealers by the company's management and underwriters in order to facilitate a securities offering.

RULE 144A An SEC exemption permitting the sale of certain restricted stock without registration.

RULE 147 See INTRASTATE OFFERING.

RULE 504 A rule under Regulation D that permits an issuer to raise up to $1,000,000 within a 12-month period. Under Rule 504, a company may offer securities to an unlimited number of investors and need not provide an offering circular to them.

RULE 505 A rule under Regulation D that exempts from registration offers and sales of securities of up to $5,000,000 during any 12-month period. Rule 505 limits the number of nonaccredited investors to 35; however, there can be an unlimited amount of accredited investors.

RULE 506 A rule under Regulation D that allows for the private placement of securities with an unlimited number of accredited investors and up to 35 "sophisticated," nonaccredited investors regardless of the dollar amount of the offering.

S CORPORATIONS Corporations that have 35 or fewer shareholders and meet certain other requirements of the Internal Revenue Code. An S corporation is taxed by the federal government and some states in a manner similar, but not identical, to a partnership.

SAFE HARBOR RULE SEC provisions that protect issuers from legal action if specified requirements have been satisfied or, in certain cases, if a good-faith effort has been made to comply with specified requirements.

SARBANES-OXLEY The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002 and represents the most significant reform in securities laws since they were first enacted. Written in response to high-profile corporate scandals, the purpose of Sarbanes-Oxley is to restore confidence in public financial reporting by prescribing fundamental changes in how audit committees, management and auditors interact and carry out their responsibilities. See Appendix A: The SEC and Securities Regulations for more information.

SECONDARY OFFERING An offering by the company's shareholders to sell some or all of their stock to the public. The proceeds of a secondary offering are received by the selling shareholders, not by the company.

SECURITIES ACT OF 1933 (1933 ACT) Under the 1933 Act, a registration statement containing required disclosures must be filed with the SEC before securities can be offered for sale in interstate commerce or through the mail. The 1933 Act also contains antifraud provisions that apply to offerings of securities.

SECURITIES EXCHANGE ACT OF 1934 (1934 ACT) The 1934 Act requires companies registered under the 1933 Act to file periodic reports (e.g., Forms 10-K and 10-Q) with the SEC and to disclose certain information to shareholders. Companies traded over the counter with 500 or more shareholders and total assets of more than $10 million and companies that elect to be listed on a national stock exchange must file a registration statement to register under the Act.

SECURITIES AND EXCHANGE COMMISSION (SEC) The SEC is the federal agency responsible for regulating sales and trading of securities through its administration of the federal securities laws, including the 1933 and 1934 Acts.

SHELF REGISTRATION Generally, a registration statement is considered effective only as long as there is a *bona fide* public offering. However, there are certain circumstances where the SEC will permit deliberately delayed or extended offerings. These are referred to as shelf registrations.

SHORT-SWING PROFIT RECAPTURE A requirement, included in the 1934 Act, whereby officers, directors, and persons deemed to have beneficial ownership of ten percent or more of a class of a company's equity securities, are required to turn over to the company any profits realized from sale of the company's stock held for less than six months.

SIGNIFICANT SUBSIDIARY A business is deemed to be significant if any of the following tests are met:

(a) The registrant's and its other subsidiaries' investments in and advances to the subsidiary exceed ten percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year (for a proposed business combination accounted for as a pooling of interests, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds ten percent of its total common shares outstanding at the date the combination is initiated); or

(b) The registrant's and its other subsidiaries' proportionate share of the subsidiary's total assets (after intercompany eliminations) exceeds ten percent of the registrant's or its subsidiaries' consolidated total assets as of the end of the most recently completed fiscal year; or

(c) The registrant's and its other subsidiaries' equity in the income of the subsidiary from continuing operations before taxes, extraordinary items, and cumulative effect of accounting changes exceeds ten percent of such income of the registrant and its subsidiaries as of the end of the most recently completed fiscal year.

These tests are performed in determining whether separate financial statements are required for businesses acquired or to be acquired or for equity method investments (materiality thresholds vary depending on the particular transaction).

SILENT FILING A filing to the SEC that entails sending a written registration statement for initial review and waiting until all SEC comments are resolved before printing the registration statement and prospectus, i.e., the first printed version is the amended registration statement. Also known as a quiet filing.

SMALL BUSINESS ISSUER A U.S. or Canadian entity with revenues of less than $25 million and whose public float is less than $25 million.

SOPHISTICATED INVESTOR Potential investors who are capable of evaluating the merits of the investment venture as related to certain exempt offerings. See also ACCREDITED INVESTOR, and consult with your legal counsel for further clarification.

STABILIZATION The process by which underwriters attempt to stabilize prices through the purchase of securities for their own account when the market price falls below the initial public offering price.

STAFF ACCOUNTING BULLETINS (SABs) SABs represent accounting interpretations and practices followed by the SEC staff in administering the disclosure requirements of the federal securities laws.

STOCK OPTION PLANS Plans whereby employees are granted options to purchase stock of the company at a stated price within a specified period of time. Stock option plans may be:

(a) Incentive stock option plans (ISOs), which are accorded favorable tax treatment (i.e., the employee has no tax at grant date or exercise date and shares are eligible for capital gains treatment on ultimate sale); however, there are a number of statutory restrictions including a limit on the number of ISOs that can be exercised in one year and the period of time that the stock must be held before it can be sold; or

(b) Nonqualified stock option plans, which are plans that are not ISOs. These plans do trigger a tax upon exercise. The issuing employer, however, can obtain a tax deduction in the period the option is exercised, whereas it would not have a deduction when an ISO is exercised.

STOP ORDER An SEC order suspending effectiveness of an issue's registration and preventing the issue from being sold, due to deficiencies being present in the registration statement.

STUB-PERIOD FINANCIAL INFORMATION Condensed financial statement information reporting results for the period subsequent to the last audited statements and prior to the effective date of the registration statement.

SUBSEQUENT OFFERING An offering of shares by a company after its initial public offering.

SYNDICATE A group of investment bankers who act together to underwrite and distribute an offering, with the intention of achieving wider distribution and spreading the associated risk.

TENDER OFFER A formal offer, usually by another company, to purchase a company's shares in order to gain control. Tender offers can be bilateral (friendly) or unilateral (unfriendly).

TESTING THE WATERS Companies filing under Regulation A may test for potential interest in their company either through oral presentations or in the form of advertisements prior to the filing and delivery of the offering statement with the SEC.

TOMBSTONE AD An advertisement, usually in a business periodical, announcing the offering and its dollar amount, identifying certain members of the underwriting syndicate, and indicating where a copy of the prospectus can be obtained.

TRANSFER AGENT An agent that keeps records of a company's shareholders and handles the transfer of shares from one individual to another.

TREASURY STOCK METHOD Method by which options, warrants, and their equivalents are included in earnings-per-share computations. It assumes that the options and/or warrants are exercised at the beginning of the year (or issue date if later) and the proceeds are used to repurchase outstanding shares of common stock.

TRUSTS Fiduciary relationship in which a person, called a trustee, holds title to property for the benefit of another person, known as the beneficiary.

UNDERWRITER Usually a firm that acts as an intermediary between the company and the investing public in connection with the sale of the company's securities.

UNDERWRITER WARRANTS Compensation to the underwriter in the form of warrants to purchase common stock.

UNDERWRITER'S DISCOUNT The commission paid to the underwriter out of the gross proceeds of an offering.

UNDERWRITING AGREEMENT Contract between the company and the underwriter that sets forth the terms and conditions of a securities offering, including the type of underwriting, the underwriter's compensation, the offering price, and number of shares. The underwriting agreement is typically signed on the effective date of the registration.

UNIT A combination of two securities sold for one price. A unit usually consists of common stock and warrants of common stock and debt.

VENTURE CAPITAL Risk financing generally provided to companies unable to obtain other forms of financing. The financing can take the form of common stock, convertible preferred stock, or convertible debentures.

WAITING PERIOD The period between the date a registration statement is initially filed with the SEC and the date the registration statement becomes effective.

WARRANT A security entitling its owner to purchase shares in a company under specified terms.

WINDOW The time during which the market is receptive to a particular type `of offering.

WITHDRAWN OR WITHDRAWAL A termination of any further offering activity by the company or the underwriter. A proposed offering is withdrawn by formally notifying the SEC.

About PricewaterhouseCoopers

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax, and advisory services for public and private clients. More than 120,000 people in 139 countries connect their thinking, experience, and solutions to build public trust and enhance value for clients and their stakeholders.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

For more information about PricewaterhouseCoopers' Private Equity Practice please visit the following Web sites:

www.pwc.com/technology

www.pwcV2R.com (VisionToReality site for entrepreneurs)

www.pwc.com/ustransactionservices

Or to reach a PricewaterhouseCoopers' business advisory specialist in your area, contact our Hotline at 1-877-PwC-TICE.

PRICEWATERHOUSECOOPERS

Roadmap for an IPO: A Guide to Going Public

*connectedthinking

BOS.04-0617.DB GCP2004