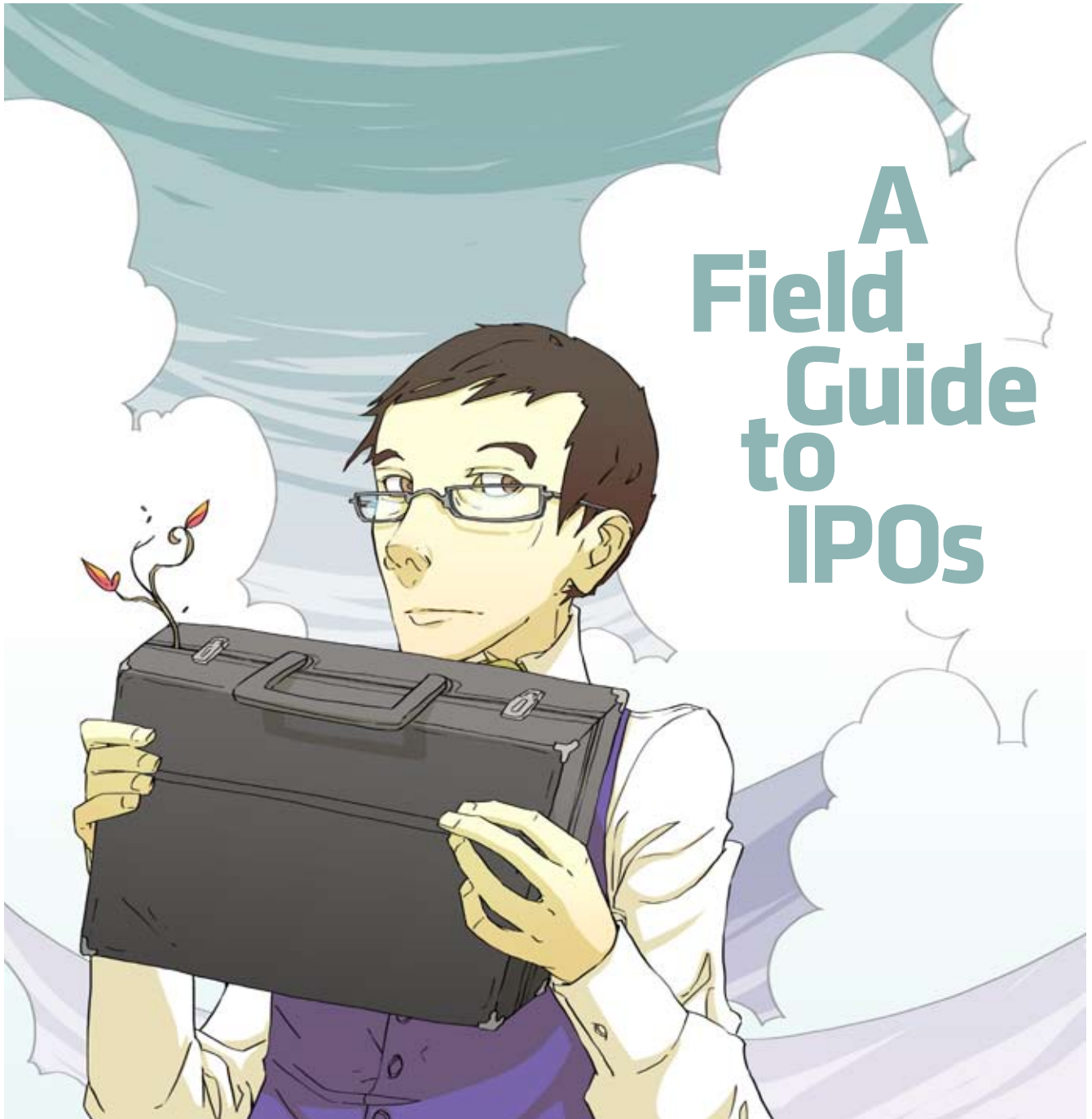


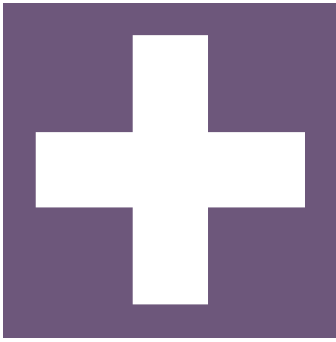
MOFO TECH



A SUPPLEMENT
TO MORRISON &
FOERSTER'S
MOFO TECH
MAGAZINE



A Field Guide to IPOs



LIFE WILL FIND A WAY

—John Hammond, *Jurassic Park* (1997)

It's amazing how many important ideas can be gleaned from a Hollywood blockbuster. "Life will find a way"—or stated differently, you have to do what you have to do in order to survive, grow, and prosper—is just one of them. For technology companies intent on finding the most reliable source of attractively priced equity capital to grow and prosper, an initial public offering has become the alternative of choice.



Now that doesn't mean that the capital markets always have been—or always will be—receptive to tech IPOs. In fact, market windows of opportunity tend to open and close with little advance notice and with considerable frequency. But the fact is that year in and year out, for several decades, IPOs have been the financing gold standard for tech companies that aspire to grow.

Over time, alternatives to IPOs have arisen and many tech companies have elected to stay private longer, often with the assistance of venture capital and private equity firms. M&A opportunities also can look very attractive to tech companies that cannot go public and either have outgrown—or worn out their welcome with—their existing financing sources. Despite the existence of alternatives, most tech companies will, when opportunity knocks, elect to go public. So, even if the knock is occasionally inaudible, it's worth thinking about how best to prepare for an IPO.

63 IPOs completed in the United States in 2009.

THE OFFERING PROCESS

The public offering process is divided into three periods: **The pre-filing period** between determining to proceed with a public offering and the actual SEC filing of the registration statement; the company is in the “quiet period” and subject to potential limits on public disclosure relating to the offering. **The waiting or pre-effective period** between the SEC filing date and the effective date of the registration statement; during this period, the company may make oral offers, but may not enter into binding agreements to sell the offered security. And **the post-effective period** between effectiveness and completion of the offering.

The Registration Statement

A registration statement contains the prospectus, which is the primary selling document, as well as other required information, written undertakings of the issuer and the signatures of the issuer and the majority of the issuer’s directors. It also contains exhibits, including basic corporate documents and material contracts. U.S. companies generally file a registration statement on Form S-1. Most non-Canadian foreign private issuers use a registration statement on Form F-1, although other forms may be available. There are special forms available to certain Canadian companies.

The Prospectus

The prospectus describes the offering terms, the anticipated use of proceeds, the company, its industry, business, management and ownership, and its results of operations and financial condition. Although it is principally a disclosure document, the prospectus also is crucial to the selling process.

A good prospectus sets forth the investment proposition.

As a disclosure document, the prospectus functions as an “insurance policy” of sorts in that it is intended to limit the issuer’s and underwriters’ potential liability to IPO purchasers. If the prospectus contains all SEC-required information, includes robust risk factors that explain the risks that the company faces, and has no material misstatements or omissions, investors will not be able to recover their losses in a lawsuit if the price of the stock drops following the IPO. A prospectus should not include “puffery” or overly optimistic or unsupported statements about the company’s future performance. Rather, it should contain a balanced discussion of the company’s business, along with a detailed discussion of risks and operating and financial trends that may affect its results of operations and prospects.

SEC rules set forth a substantial number of specific disclosures required to be made in the prospectus. In addition, federal securities laws, particularly Rule 10b-5 under the Securities Exchange Act of 1934, require that documents used to sell a security contain all the information material to an investment decision and do not omit any information necessary to avoid misleading potential investors. Federal securities laws do not define materiality; the basic standard for determining whether information is material is whether a reasonable investor would consider the particular information important in making an investment decision. That simple statement is often difficult to apply in practice.

An issuer should be prepared for the time-consuming drafting process, during which the issuer,

TAXING THOUGHTS

Companies organized as S corporations, partnerships, or LLCs taxed as partnerships, which do not pay federal income tax at the entity level, should consider the potential tax implications of an IPO.

For S corporations, an IPO generally terminates S status for federal income tax purposes. The former S corporation is generally taxed as a C corporation and, as a result, will now be subject to a corporate level tax. Going public will also result in the S corporation having two short tax years—one, the S short year, which ends the day before the IPO, and the other, the C short year, which begins on the IPO date. In general, income and loss of the S corporation for the entire year in which the IPO occurs must be allocated between the S and C short years on a daily pro-rata basis. This could produce inequities. If the S corporation is a cash method taxpayer, conversion to a C corporation generally requires it to use the accrual method of accounting. This could lead to adjustments under Section 481 of the Internal Revenue Code to avoid duplication or omission of income items or deductions. These adjustments may be taxable income to the former S corporation shareholders. To avoid these potential problems, the S shareholders may elect a “closing of the books” allocation under certain circumstances.

Shareholders of the former S corporation may want to receive distributions from the S corporation to cover tax obligations attributable to flow-through items for the S short year. If such tax distributions are made after the IPO, it may be taxable to the former S corporation shareholders.

Partnerships will generally lose their pass-through tax status on conversion to a C corporation in connection with an IPO. Revenue Ruling 84-111, 1984-2 C.B. 88, sets forth the tax consequences of converting from a partnership to a C corporation, and describes several alternatives wherein each alternative assumes no consideration other than that stock is received by the partnership or its partners. If the transaction meets the applicable requirements of Code Section 351, then it will be tax-free to the partnership so long as the corporation does not assume partnership liabilities (or receive property of the partnership subject to liabilities) in excess of the basis of the contributed assets.

Careful tax planning is recommended to address these concerns.



DESS REHEARSAL

Well before its IPO, an issuer should begin to approach executive compensation as would a public company. The IPO registration statement requires the same enhanced executive compensation disclosures that public companies provide in their annual proxy statements, including a discussion of compensation philosophy, an analysis of how compensation programs implement that philosophy and a discussion of the effects of risk-taking on compensation decisions.

Issuers contemplating an IPO should consider:

Systematizing compensation practices.

Compensation decisions should be made more systematically—doing so may require:

- establishing an independent compensation committee of the board of directors.
- using formal market information to set compensation.
- establishing a regular compensation grant cycle.

Confirming accounting and tax treatment.

The issuer should be sure that the Internal Revenue Code Section 409A valuation used to establish stock value for stock option purposes is consistent with that used for financial accounting purposes. The issuer also should consider whether to limit option grants as the IPO effective date approaches. Option grants close to an IPO may raise “cheap stock” issues.

Securities law compliance. The issuer should confirm that equity grants were made in compliance with federal and state securities rules, including Rule 701 limits, to avoid rescission or other compliance concerns.

Adopting plans. An issuer will have greater flexibility to adopt compensation plans prior to its IPO. Accordingly, planning ahead is essential. An issuer should adopt the plans it thinks it may need during its first few years of life as a public company (including an equity plan, employee stock purchase plans, and Code Section 162(m) “grandfathered” bonus plans), and reserve sufficient shares for future grants. Public companies are required to obtain shareholder approval for new compensation plans and material amendments.

investment bankers, and their respective counsel work together to craft the prospectus disclosure.

The Pre-Filing Period

The pre-filing period begins when the company and the underwriters agree to proceed with a public offering. During this period, key management personnel will generally make a series of presentations covering the company’s business and industry, market opportunities, and financial matters. The underwriters will use these presentations as an opportunity to ask questions and establish a basis for their “due diligence” defense.

From the first all-hands meeting forward, all statements concerning the company should be reviewed by the company’s counsel to ensure compliance with applicable rules. Communications by an issuer more than 30 days prior to filing a registration statement are permitted as long as they do not reference the securities offering. Statements made within 30 days of filing a registration statement that could be considered an attempt to pre-sell the public offering may be considered an illegal prospectus, creating a “gun-jumping” violation. This might result in the SEC’s delaying the public offering or requiring prospectus disclosures of these potential securities law violations. Press interviews, participation in investment banker-sponsored conferences, and new advertising campaigns are generally discouraged during this period.

In general, at least four to six weeks will pass between the distribution of a first draft of the registration statement and its filing with the SEC. To a large extent, the length of the pre-filing period will be determined by the amount

of time required to obtain the required financial statements.

The Waiting Period

Responding to SEC Comments on the Registration Statement

The SEC targets 30 calendar days from the registration statement filing date to respond with comments. It is not unusual for the first SEC comment letter to contain a significant number of comments that the issuer must respond to both in a letter and by amending the registration statement. After the SEC has provided its initial set of comments, it is much easier to determine when the registration process is likely to be completed and the offering can be made. In most cases, the underwriters prefer to delay the offering process and to avoid distributing a preliminary prospectus until the SEC has reviewed at least the first filing and all material changes suggested by the SEC staff have been addressed.

Preparing the Underwriting Agreement, the Comfort Letter, and Other Documents

During the waiting period, the company, the underwriters and their counsel, and the company’s independent auditor will negotiate a number of agreements and other documents, particularly the underwriting agreement and the auditor’s “comfort letter.”

The underwriting agreement is the agreement pursuant to which the company agrees to sell, and the underwriters agree to buy, the shares and then sell them to the public; until this agreement is signed, the underwriters do not have an enforceable obligation to acquire the offered shares. The underwriting agreement is not signed until the offering is priced. In the typical IPO, the underwriters

Tech companies represent the second-largest segment of IPO issuers.

NYSE vs NASDAQ: Principal Quantitative Listing Requirements

The following table summarizes the principal quantitative listing requirements; there are also qualitative requirements.

Selected Listing Requirement	NYSE	Nasdaq Global Market ¹
Minimum Number of Shareholders	400 round lot holders	Same
Minimum Number of Publicly Held Shares	1,100,000*	Same, with similar exclusions.
Minimum Aggregate Market Value of Publicly Held Shares	Generally \$40M*	Any of: <ul style="list-style-type: none"> ■ Income Standard: \$8M ■ Equity Standard: \$18M ■ Market Value Standard: \$20M ■ Total Assets/Total Revenue Standard: \$20M
Minimum Price Per Share	At least \$4.00 at initial listing	Same
Minimum Number of Market Makers	N/A	Four, unless company qualifies for listing under the Income or Equity Standards, which each require three.
Minimum Financial Standards	<p>One of the following:</p> <ul style="list-style-type: none"> ■ Earnings Test: Pre-tax earnings from continuing operations, subject to adjustments, must total (1) \$10M for the last three fiscal years, including a minimum of \$2M in each of the two most recent fiscal years and positive amounts in all three years, or (2) \$12M for the last three fiscal years, including a minimum of \$5M in the most recent fiscal year and \$2M in the next most recent fiscal year. ■ Valuation/Revenue with Cash Flow Test: (1) \$500M in global market cap, (2) \$100M in revenues during the most recent 12-month period, and (3) \$25M aggregate cash flows for the last three fiscal years with positive amounts in all three years, subject to adjustment. ■ Pure Valuation/Revenue Test: (1) \$750M in global market cap, and (2) \$75M in revenues during the most recent fiscal year. ■ Affiliated Company Test: (1) \$500M in global market capitalization, (2) parent or affiliated company is a listed company in good standing, and (3) parent or affiliated company retains control of, or is under common control with, the entity. ■ Assets and Equity Test: (1) \$150M in global market cap, and (2) \$75M in total assets, including \$50M in stockholders' equity, subject to adjustment. 	<p>One of the following:</p> <ul style="list-style-type: none"> ■ Income Standard: (1) \$1M in annual pre-tax income from continuing operations in most recently completed fiscal year or in two of the three most recently completed fiscal years, and (2) stockholders' equity of \$15 million. ■ Equity Standard: stockholders' equity of \$30M. ■ Market Value Standard: N/A for IPO. ■ Total Assets/Total Revenue Standard: total assets + total revenue of \$75M each for the most recently completed fiscal year or two of the three most recently completed fiscal years.

*Shares held by directors, officers, or immediate families and other concentrated holdings of 10% or more are excluded.
¹The other tiers (Nasdaq Global Select Market and Nasdaq Capital Market) have similar requirements.

will have a “firm commitment” to buy the shares once they sign the underwriting agreement.

Underwriters’ counsel will submit the underwriting agreement, the registration statement, and other offering documents for review to the Financial Industry Regulatory Authority (FINRA), which is responsible for reviewing the terms

of the offering to ensure that they comply with FINRA requirements. An IPO cannot proceed until the underwriting arrangement terms have been approved by FINRA.

In the “comfort letter,” the auditor affirms (1) its independence from the issuer, and (2) the compliance of the financial statements with applicable accounting require-

ments and SEC regulations. The auditor also will note period-to-period changes in certain financial items. These statements follow prescribed forms and are usually not the subject of significant negotiation. The underwriters will also usually require that the auditor undertake certain “agreed-upon” procedures in which it compares financial

Foreigners Welcome!

Foreign private issuers benefit from less onerous securities law requirements. A “foreign private issuer” (FPI) is a foreign issuer, other than a foreign government, that meets these conditions:

- No more than 50% of its outstanding voting securities are directly/indirectly owned of record by U.S. residents.
- Less than a majority of its executive officers or directors are U.S. citizens or residents.
- No more than 50% of its assets are located in the U.S.
- Its business is administered principally outside the U.S.

FPIs receive certain accommodations, including:

- Interim (rather than quarterly) reporting based on home country and stock exchange practice.
- Exemption from proxy rules and from Section 16 insider reporting and short swing profit recovery provisions.
- Aggregate (rather than individual) executive compensation disclosure, if permitted by home country.
- Offering document financial statements updated semi-annually (not quarterly).
- No obligation to apply U.S. GAAP—

although reconciliation of significant variations may be required.

- Form 6-K filings furnished not filed; no Forms 8-K.
- No CEO/CFO certifications of interim financial information.
- Certain corporate governance requirements are satisfied by home country requirements.
- Pre-marketing IPO SEC filings may be made confidentially.

However, like U.S. companies, FPIs are subject to the Sarbanes-Oxley Act requirements governing internal control over financial reporting.

information in the prospectus (outside of the financial statements) to the issuer’s accounting records to confirm its accuracy.

Marketing the Offering

During the waiting period, marketing begins. The only written sales materials that may be distributed during this period are the preliminary prospectus and additional materials known as “free writing prospectuses,” which must satisfy

specified SEC requirements. While binding commitments cannot be made during this period, the underwriters will receive indications of interest from potential purchasers, indicating the price they would be willing to pay and the number of shares they would purchase. Once SEC comments are resolved, or it is clear that there are no material open issues, the issuer and underwriters will undertake a two- to three-week “road show,” during which company

management will meet with prospective investors.

Once SEC comments are cleared and the underwriters have assembled indications of interest for the offered securities, the company and its counsel will request that the SEC declare the registration statement “effective” at a certain date and time, usually after the close of business of the U.S. securities markets on the date scheduled for pricing the offering.

The Post-Effective Period

Once the registration statement has been declared effective and the offering has been priced, the issuer and the managing underwriters execute the underwriting agreement and the auditor delivers the final comfort letter. This occurs after pricing and before the opening of trading on the following day. The company then files a final prospectus with the SEC that contains the final offering information.

On the third or fourth business day following pricing, the closing occurs, the shares are issued, and

AN OUNCE OF PREVENTION

Underwriters and their counsel will focus on your company’s intellectual property portfolio. Prepare in advance for the IPO IP diligence process. Speak with your IP counsel. Underwriters generally have a few areas of potential concern:

STRENGTH OF PATENT POSITION

Do your patents cover your commercial products?
Are your patent claims easy to design around?
Are your patents invalid or otherwise defective?
And do you have a sufficient period of exclusivity?

THIRD-PARTY INFRINGEMENT RISKS

Are there any third-party patents or other IP that

pose potential infringement risks, and if so, what is your strategy for mitigating those risks?

OWNERSHIP ISSUES

Does your company own or have all rights to license and use its patents, software, and other IP? Do any inventors have an obligation to assign to another entity or company? And is IP ownership generally clean?

Advance preparation will not only demonstrate a level of sophistication and commitment to the IPO process, but will also help you avoid potential pitfalls along the way. Ask at the outset about the type of IP opinion that will be requested at closing.

The Big Four accounting firms were the most active accounting firms

the issuer receives the proceeds. The closing completes the offering process. Then, for the following 25 days, aftermarket sales of shares by dealers must be accompanied by the final prospectus or a notice with respect to its availability. If during this period there is a material change that would make the prospectus misleading, the company must file an amended prospectus.

ADVANCE PLANNING

Most companies must make legal and operational changes before proceeding with an IPO. A company cannot wait to see if its IPO is likely to be successful prior to implementing most of these changes. Many corporate governance matters, federal securities law requirements (including Sarbanes-Oxley) as well as applicable securities exchange requirements must be met when the IPO registration statement is filed, or the issuer must commit to satisfy them within a set time period.

A company proposing to list securities on an exchange should review differing governance requirements of each exchange, as well as their respective financial listing requirements before determining which exchange to choose. An issuer must also address other corporate governance matters, including board structure, committees and member criteria, related party transactions, and director and officer liability insurance. The company should undertake a thorough review of its compensation scheme for its directors and officers, as well, particularly its use of equity compensation.

Primary and Secondary Offerings

An IPO may consist of the sale of newly issued shares by the company (a “primary” offering), or a sale of

already issued shares owned by shareholders (a “secondary” offering), or a combination of these. Underwriters may prefer a primary offering because the company will retain all of the proceeds to advance its business. However, many IPOs include secondary shares, either in the initial part of the offering or as part of the 15% over-allotment option granted to underwriters. Venture capital and private equity shareholders view a secondary offering as their principal realization event. An issuer must consider whether any of its shareholders have registration rights that could require the issuer to register shareholder shares for sale in the IPO.

Cheap Stock

“Cheap stock” describes options granted to employees of a pre-IPO company during the 18-24 months prior to the IPO where the exercise price is deemed (in hindsight) to be considerably lower than the fair market value of the shares at grant date. If the SEC determines (during the comment process) that the company has issued cheap stock, the company must incur a compensation expense that will have a negative impact on earnings. The earnings impact may result in a significant one-time charge at the time of the IPO as well as going-forward expenses incurred over the option vesting period. In addition, absent certain limitations on exercisability, an option granted with an exercise price that is less than 100% of the fair market value of the underlying stock on the grant date will subject the option holder to an additional 20% tax pursuant to Section 409A of the Code.

The dilemma that a private company faces is that it is unable to predict with certainty the eventual IPO price. A good-faith pre-IPO



D & O

INSURANCE

Directors and officers (D&O) insurance protects directors and officers from losses resulting from their service to a company. Typically, a D&O insurance policy maintained by a private company will not provide coverage for securities offerings, such as an IPO, and will not contain the coverage or provisions applicable to public companies.

A company that is going public should review its existing D&O coverage and seek additional coverage. A public company's D&O insurance program generally contains three types of coverage in one policy:

Side A covers D&Os' costs and expenses for defense and due to payouts under settlements and judgments, where indemnification may not otherwise be available, such as due to state law limitations.

Side B provides reimbursement to the company if it has indemnified D&Os in connection with a claim. Side B coverage is the most commonly invoked portion of a D&O policy.

Side C known as “entity coverage,” covers the company itself. For public companies, coverage usually includes only claims resulting from alleged securities law violations.

Most D&O insurance policies have complicated applications and impose compliance obligations upon the company. False statements in the application or failure to comply with these obligations can result in the loss of coverage if any substantial liabilities arise. As a result, a company will want to be certain that it has one or more employees who have appropriate experience preparing the application, and who will assume compliance responsibilities once the policy is effective.

involved in IPOs.





SARBANES-OXLEY ACT OF 2002

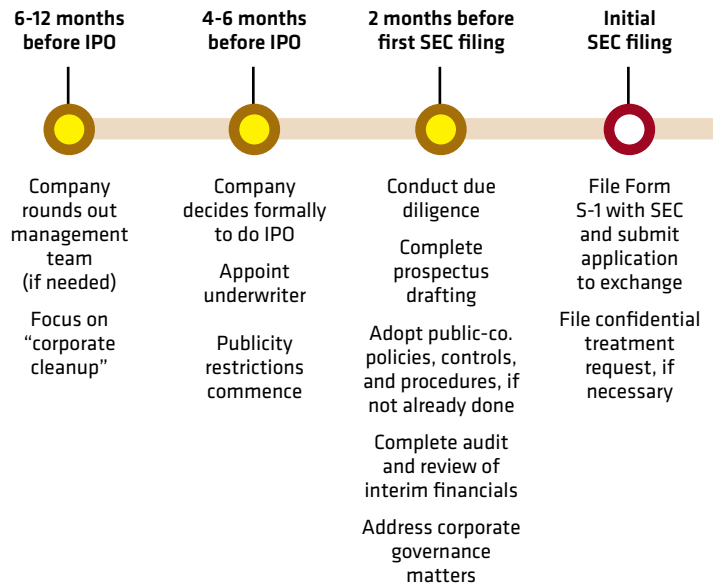
The Sarbanes-Oxley Act of 2002 requires publicly traded companies to implement corporate governance policies and procedures that are intended to provide minimum structural safeguards to investors. Certain of these requirements are phased in after the IPO.

Key provisions include:

- Requirements related to the company's internal control over financial reporting, including (1) management's assessment and report on the effectiveness of the company's internal controls on an annual basis, with additional quarterly review obligations, and (2) audit of the company's internal controls by its independent registered public accounting firm.
- Prohibition of most loans to directors and executive officers (and equivalents thereof).
- The CEO and CFO of a public company must certify each SEC periodic report containing financial statements.
- Adoption of a code of business conduct and ethics for directors and senior executive officers.
- Required "real time" reporting of certain material events relating to the company's financial condition or operations.
- Disclosure of whether the company has an "audit committee financial expert" serving on its audit committee.
- Disclosure of material off-balance sheet arrangements and contractual obligations.
- Audit committee approval of any services provided to the company by its audit firm, with certain exceptions for *de minimis* services.
- Whistleblower protections for employees who come forward with information relating to federal securities law violations.
- Compensation disgorgement provisions applicable to the CEO and CFO upon a restatement of financial results attributable to misconduct.

The exchanges' listing requirements contain related substantive corporate governance requirements regarding independent directors; audit, nomination, and compensation committees; and other matters.

Sequencing Key Events



fair market value analysis can yield different conclusions when compared to a fair market value analysis conducted by the SEC in hindsight based on a known IPO price. There is some industry confusion as to the acceptable method for calculating the fair market value of non-publicly traded shares and how much deviation from this value is permitted by the SEC. Companies often address this "cheap stock" concern by retaining an independent appraiser to value their stock options. However, it now appears that most companies are using one of the safe-harbor methods for valuing shares prescribed in the Section 409A regulations.

Governance and Board Members

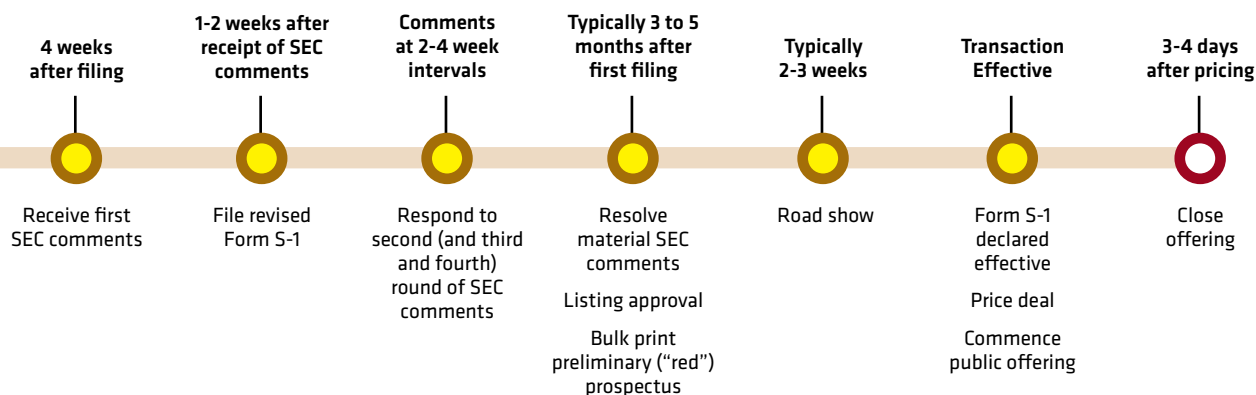
A company must comply with significant corporate governance requirements imposed by the federal securities laws and regulations and the regulations of the applicable exchanges, including with regard to

the oversight responsibilities of the board of directors and its committees. A critical matter is the composition of the board itself. All exchanges require that, except under limited circumstances, a majority of the directors be "independent" as defined by both the federal securities laws and regulations and exchange regulations. In addition, boards should include individuals with appropriate financial expertise and industry experience, as well as an understanding of risk management issues and public company experience. A company should begin its search for suitable directors early in the IPO process even if it will not appoint the directors until after the IPO is completed. The company can turn to its large investors as well as its counsel and underwriters for references regarding potential directors.

THE UNDERWRITER'S ROLE

A company will identify one or more lead underwriters that will be responsible for the IPO. A com-

From 2006 to 2009, the lock-up period was 180 days (72.7% of IPOs).



pany chooses an underwriter based on its industry expertise, including the knowledge and following of its research analysts, the breadth of its distribution capacity, and its overall reputation. A company should consider the underwriter's commitment to the sector and its distribution strengths. For example, does the investment bank have a particularly strong research distribution network, or is it focused on institutional distribution? Is its strength domestic, or does it have foreign distribution capacity? The company may want to include a number of co-managers in order to balance the underwriters' respective strengths and weaknesses.

A company should keep in mind that underwriters have at least two conflicting responsibilities—to sell the IPO shares on behalf of the company and to recommend to potential investors that the purchase of the IPO shares is a suitable and a worthy investment.

In order to better understand the company—and to provide a defense in case the underwriters are sued in connection with the IPO—the underwriters and their counsel are likely to spend a substantial amount of time performing business, financial, and legal due diligence in connection with the IPO, and making sure that the prospectus and any other offering materials are consistent with the information provided. The underwriters will market the IPO shares, set the price (in consultation with the company) at which the shares will be offered to the public and, in a "firm commitment" underwriting, purchase the shares from the company and then re-sell them to investors. In order to ensure an orderly market for the IPO shares, after the shares are priced and sold, the underwriters are permitted in many circumstances to engage in certain stabilizing transactions to support the stock.

FINANCIAL REPORTING AND ACCOUNTING

The IPO registration statement must include audited financial statements for the last three fiscal years; financial statements for the most recent fiscal interim period, comparative with interim financial information for the corresponding prior fiscal period (may or may not be audited depending on the circumstances); and income statement and condensed balance sheet information for the last five years (the earliest two years may be derived from unaudited financial statements) and interim periods presented.

Early on, the issuer should identify any problems associated with providing the required financial statements in order to seek necessary accommodation from the SEC. These statements must be prepared in accordance with U.S. GAAP, as they will be the source of information for "Management's Discussion and Analysis of Financial Condition and

Controlling Your Shares

In connection with an IPO, the issuer may want the option to “direct” shares to directors, officers, employees and their relatives, or specific other designated people, such as vendors or strategic partners.

Directed share (or “family and friends”) programs, or DSPs, set aside stock for this purpose, usually 5-10% of the total shares offered in the IPO. Participants pay the initial public offering price. Shares not sold pursuant to the DSP are sold by the underwriters.

Generally, directed shares are freely tradable securities and are not subject to the underwriter’s lock-up agreement, although the shares may be locked up for some shorter period. Each underwriter has its own program format. There are, however, guidelines that must be followed. The DSP is not a separate offering by the company but is part of the plan of distribution of the IPO shares and must be sold pursuant to the IPO prospectus.

To provide for an orderly market and to prevent existing shareholders from dumping their shares into the market immediately after the IPO, underwriters will require the issuer as well as directors, executive officers, and large shareholders (and sometimes all pre-IPO shareholders) to agree not to sell their shares of common stock, except under limited circumstances, for a period of up to 180 days following the IPO, effectively “locking up” such shares. Exceptions to the lock-up include issuances of shares in acquisitions and in compensation-based grants. Shareholders may be permitted to exercise existing options (but not sell the underlying shares), transfer shares to family trusts, and sometimes to make specified private sales, provided that the acquiror also agrees to be bound by the lock-up restrictions. These lock-up exceptions will be highly negotiated.

Results of Operations” (MD&A). The SEC will review and comment on the financial statements and the MD&A. The SEC’s areas of particular concern are:

- revenue recognition
- business combinations
- segment reporting
- financial instruments
- impairments of all kinds
- deferred tax valuation allowances
- compliance with debt covenants, fair value, and loan losses.

An issuer will not be required to include either a management’s report on its internal control over financial reporting or an auditor’s report on such internal control until the second annual report following its IPO.

SEC COMMENTS

An integral part of the IPO process is the SEC’s review of the registration statement. Once the registration statement is filed, a team of SEC staff members is assigned to review the filing. The team con-

sists of accountants and lawyers, including examiners and supervisors. The SEC’s objective is to assess the company’s compliance with its registration and disclosure rules. The SEC review process should not be viewed as a “black box” where filings go in and comments come out—rather, as with much of the IPO process, the relationship with the SEC is a collaborative process.

The Process

The SEC’s principal focus during the review process is on disclosure. In addition to assessing compliance with applicable requirements, the SEC considers the disclosures through the eyes of an investor in order to determine the type of information that would be considered material. The SEC’s review is not limited to just the registration statement. The staff will closely review websites, databases, and magazine and newspaper articles, looking in particular for information that the staff thinks should be in the prospectus or that contradicts informa-

tion included in the prospectus.

The review process is time-consuming. While there was a time when the review process could be completed in roughly a couple of months, now, given the length of the prospectus and the complexity of the disclosure, it can take three to five months. This depends on the complexity of the company’s business and the nature of the issues raised in the review process.

Initial comments on Form S-1 are provided in about 30 days—depending on the SEC’s workload and the complexity of the filing, the receipt of first-round comments may be sooner or later. The initial letter typically runs about 50 to 75 comments, with a majority of the comments addressing accounting issues. The company and counsel will prepare a complete and thorough response. In some instances, the company may not agree with the SEC staff’s comment, and may choose to schedule calls to discuss the matter with the staff. The company will file an amendment revis-

Tech companies represent a significant part of the backlog of pending

ing the prospectus, and provide the response letter along with any additional information. The SEC staff generally tries to address response letters and amendments within 10 days, but timing varies considerably.

Frequent Areas of Comment

It is easy to anticipate many of the matters that the SEC will raise in the comment process. The SEC makes the comment letters and responses from prior reviews available on its website, so it is possible to determine the most typical comments raised during the IPO process.

Overall, the SEC staff looks for a balanced, clear presentation of the information required in the registration statement. Some of the most frequent comments raised by the SEC staff on disclosure, other than the financial statements, include:

- **Front cover and gatefold:** On the theory that “a picture is worth a thousand words,” does the artwork present a balanced presentation of the company’s business, products, or customers?
- **Prospectus summary:** Is the presentation balanced?
- **Risk factors:** Are the risks specific to the company and devoid of mitigating language?
- **Use of proceeds:** Is there a specific allocation of the proceeds among identified uses, and if funding acquisitions is a designated use, are acquisition plans identified?
- **Selected financial data:** Does the presentation of non-GAAP financial measures comply with SEC rules?
- **Management’s Discussion & Analysis:** Does the discussion address known trends, events, commitments, demands, or uncertainties, including the impact of the economy, trends with respect

to liquidity, and critical accounting estimates and policies?

- **Business:** Does the company provide support for statements about market position and other industry or comparative data? Is the disclosure free of, or does it explain, business jargon? Are the relationships with customers and suppliers, including concentration risk, clearly described?
- **Management:** Is the executive compensation disclosure, particularly the compensation discussion and analysis, clear? Does it include discussion of performance targets, benchmarking, and individual performance?
- **Underwriting:** Is there sufficient disclosure about stabilization activities (including naked short selling), as well as factors considered in early termination of lock-ups and any material relationships with the underwriters?
- **Exhibits:** Do any other contracts need to be filed based on disclosure in the prospectus?

A FINAL THOUGHT

While windows open and close, and tech companies may have different views concerning the right moment to commence active and intense preparation for an IPO, it is rarely too early to undertake the advance planning described above. Much of this preparatory work is neither time-consuming nor expensive. Yet it will enhance greatly the opportunity to get into the market quickly, when the market is there. And even if an IPO does not turn out to be the option of choice, this preparatory work should prove valuable in facilitating other funding opportunities, or even acquisition by an existing public company. ■



HOW MUCH DOES AN IPO COST?

IPO expenses can add up quickly, as company personnel and professionals scramble to meet substantial demands in short timeframes. The table presents approximate costs for a \$200 million IPO.

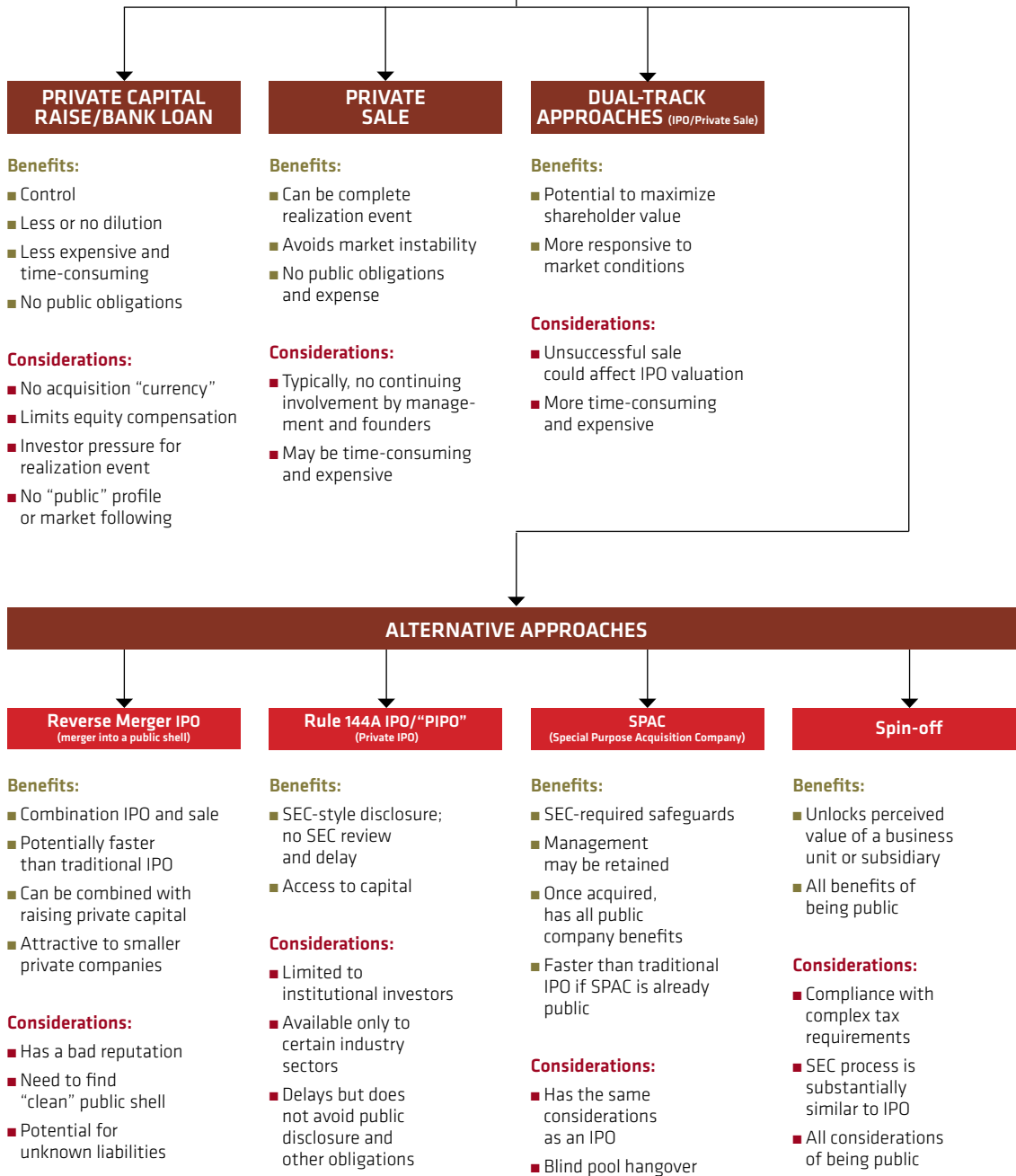
\$200,000,000	Gross proceeds from the IPO
14,000,000	Underwriting discount (7% of gross proceeds)
34,760	Regulatory filing fees (SEC and FINRA)
155,000	Nasdaq listing fee
800,000	Legal fees and expenses
1,000,000	Accounting fees and expenses
15,000	Transfer Agent fees and expenses
200,000	Road show expenses
400,000	Printing expenses
\$183,395,240	Net proceeds



The Likely Alternatives

A growing tech company has a number of financing alternatives, in addition to a traditional firm commitment, underwritten IPO.

WHICH WAY TO GO?



MOFO TECH+ is a custom publication produced for Morrison & Foerster LLP by Leverage Media LLC, Dobbs Ferry, NY.

Editorial Director: Michael Winkelman // Art Director: James Van Fleteren // Production Director: Rosemary P. Sullivan

Copy Editor: Sue Khodarahmi // Illustrations: Michelle Lamoreaux

©2010 by Morrison & Foerster LLP. All Rights Reserved. Morrison & Foerster and MoFo Tech are trademarks of Morrison & Foerster LLP.

Morrison & Foerster (UK) LLP is regulated by the Solicitors Regulation Authority. A list of Partners of Morrison & Foerster (UK) LLP, a Delaware Limited Liability Partnership, is available at our offices. Leverage Media LLC is a member of the Custom Content Council.