

# Hutchison + Mason PLLC

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## Finding Neverland – Keeping the IPO Dream Alive

With the recent successful closing of Icagen's initial public offering and with several other local companies currently waiting in the wings, many area entrepreneurs once again have begun thinking about their own rags to riches story – taking the idea that they brought to life in their garage, through several rounds of financing, culminating in a highly successful IPO. But for many, the IPO process remains a mystery. How do you take a company public? Who are the players? How long will it take? What are the costs?

### Cast of Characters

Every good IPO, like every good movie, needs to start with a star. Of course the star in this production is the company and its management team. The star has spent many years honing its craft, starting with bit parts in trade shows or investor conferences, graduating to several off-Broadway roles in VC financings and is now looking for a starring role in major Hollywood production. If the star has been around for a few years it might need a facelift, some make-up or a new wardrobe – likely new corporate governance policies, equity compensation plans, anti-takeover measures and insider trading policies, all of which will need to be in place once the company is public.

The bankers, or underwriters, are the studio executives behind the making of the IPO, working with the star to market and sell the company's stock in the IPO. Typically, the star will choose one lead underwriter and a few additional co-managing underwriters and will work closely with these studio executives to refine its message to the public and define its place in the market. Just like the big time Hollywood movie houses, at the closing of an IPO the underwriters purchase the star's offering (in this case shares in the IPO) and sell it to the public. Unlike Hollywood, under federal securities laws, underwriters are liable for material misstatements and omissions in the offering materials. As a result, they will spend a great deal of time during the process conducting due diligence on the star's business, affairs, financial condition and prospects.

The next major player in this production is the director, or company counsel, who is responsible for providing advice to the star and managing most of the pre-production process other than the marketing and sales aspects. Frequently, the director in an IPO is the same firm who has traditionally served as the star's outside corporate counsel, as stars often find it helpful to work with directors who know their long and occasionally sordid history. The director will work together with the rest of the cast to write the script, in this case the "Registration Statement," describing the company's business and prospects and ensuring that it does not contain any material misstatements or omissions. The director will investigate the affairs of the star and even do the help the star with its housekeeping – updating capitalization tables, approving past actions, obtaining third-party consents, etc. The studio executives'

assistant, a/k/a underwriters' counsel, will be primarily responsible for spearheading the studio executives' due diligence efforts, negotiating the agreement between the star and the studio executives (the Underwriters' Agreement) and corresponding with the NASD.

Finally, you have the accountants, who play the same role in an IPO as they would in a movie production - accountants. You will immediately recognize the accountants; they are the ones with large bags under their eyes, bulging wallets and smiles from ear to ear stemming from the huge increase in work they have experienced as a result of the passage of the Sarbanes-Oxley Act and the related rule making activity. In IPO-land scripts are required to have audited financial results for the last three completed fiscal years – if those audits have not been completed prior to the commencement of the IPO production process, the accountants will likely have to spend a lot of late nights crunching numbers. In addition, the accountants will be responsible for certifying the numbers used in the script, testing and certifying a star's "internal controls," and helping the star refine the narrative discussion of its financial statements in the script.

### **Pre-Production**

Typically, the IPO pre-production process starts with an organizational meeting where the star spends a full day presenting to and responding to questions from the studio executives and their assistants, the director and the accountants. During this meeting the cast will come to a better understanding of the star, its motivations and, most importantly, its business. Following the organizational meeting, the cast will begin drafting the script, or Registration Statement, which will be filed with the censors of all things relating to public companies, the SEC. The drafting of the script is a collaborative effort with each of the participants bringing a different perspective to the table. The studio executives will want to make sure that it can market and sell the script to the public, the director will want to make sure that the script does not contain any material misstatements or omissions and the accountants will want to make sure that the script accurately reflects the star's financial position. Usually, it takes between four and six weeks to arrive at a script that the cast feels comfortable filing with the censors.

The SEC has 30 days to respond with its comments to the Registration Statement. Usually, the SEC will take the full 30 days (and some times an extra day or two) before responding. The SEC's comments (often in excess of 100) will address disclosure, legal and accounting issues. The comments are reviewed by the cast and then divided up among the cast members. Ultimately, the director will be responsible for collecting the input from the various cast members and preparing a response to the SEC comments on behalf of the star. The SEC will review the response and issue a new set of comments to which the cast will again respond. This back and forth will take place several times over the following few weeks with the list of SEC comments growing shorter each time. Once the cast feels that they have sufficiently narrowed the comments and there are no longer any unresolved material issues, they will print the preliminary prospectus, or "Red Herring," from the pages of the script and hit the road to market the production.

The Road Show is a grueling ten to fourteen day tour of 20 to 30 cities across the U.S. and often a few cities in Europe. During the Road Show the studio executives will set up a series of meetings with prospective investors. Legend has it that along the way, the star is forced to eat copious amounts of sushi and guzzle gallons of the finest wine between plane flights and investor presentations. Following the Road Show, the studio executives will circle back with the potential investors to gauge the amount of interest in the offering. Meanwhile back at the ranch, the director, the studio executives' assistant and

the accountants will continue to respond to SEC comments until they have resolved all of the issues raised by the SEC, at which time the offering can be declared effective.

Taking into account the initial drafting of the Registration Statement, the back and forth with the SEC and the marketing on the Road Show, even the fast IPO productions take three to four months to complete. All of this hard work culminates in the pricing meeting. In advance of the meeting the star will request that the SEC declare the offering effective. At the meeting the studio executives will detail the indications of interest they have received from potential investors and based on this input will make a recommendation as to the appropriate price for the offering. If the star accepts the recommended price, the champagne corks will be popped, the star's shares will begin trading the following day and the star will receive the proceeds of the offering three business days later when the final prospectus will be distributed to investors.

### **Production Costs**

An IPO, like any big budget Hollywood production, is not without its significant costs. The underwriters will receive a fee equal to 7% of the amount raised and the accountants' and attorneys' fees will likely be between \$750,000 and \$1 million each depending on the amount and scope of their services. Throw in a few hundred thousand dollars for printer fees and another couple hundred thousand dollars for filing fees and other miscellaneous expenses and it becomes quite likely that a star raising \$100 million will spend \$10 million on offering expenses, and this doesn't account for the annual expenses that a star incurs after going public which most estimate to be in excess of \$1,000,000 per year - a steep price to pay, but well worth it when you arrive at the Academy Awards with your 100 Million Dollar Baby.