2006 IPO Report

WilmerHale®

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2006 Review

With 198 offerings, deal volume in the 2006 US IPO market was essentially unchanged from the prior two years. However, total gross proceeds for the year increased 29% from 2005 to reach $40.4 billion in 2006, due largely to the return of super-sized IPOs, which more than offset an increase in the number of venture-backed and technology-related IPOs (which tend to be smaller).

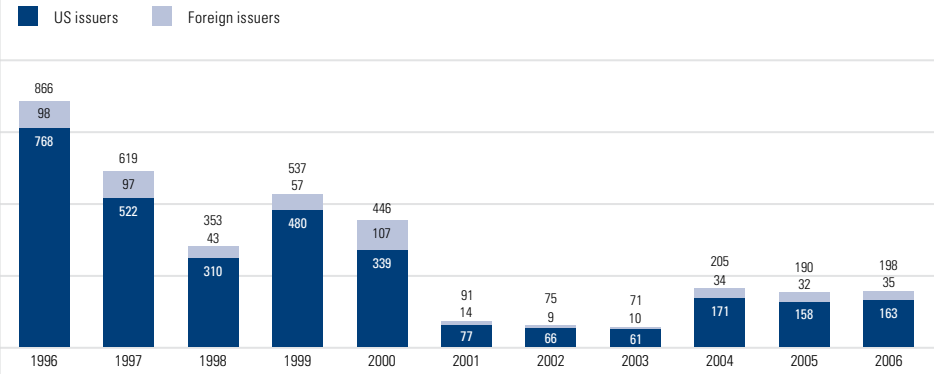
While the annual deal totals in the last three years suggest the IPO market may have reached a new plateau—at roughly two and one-half times the average of 79 IPOs per year between 2001 and 2003—the year ended with strong momentum, and the market appears poised for further growth in 2007. With 78 IPOs generating gross proceeds of $15.3 billion, the fourth quarter produced the largest quarterly number of IPOs since the third quarter of 2000.

The number of US-issuer IPOs inched up from 158 in 2005 to 163 in 2006, while gross proceeds increased from $26.2 billion to $29.4 billion. Billion-dollar offerings by US issuers increased from just one in 2005 to four in 2006, led by the $2.4 billion MasterCard IPO (dwarfed, however, by a $21.9 billion IPO on the Hong Kong exchange). Median deal size by US issuers decreased from $102.6 million to $100.8 million, however, as the spike in very large offerings was coupled with an increase in smaller tech company deals.

The number of foreign-based issuer IPOs increased from 32 in 2005 to 35 in 2006, and gross proceeds more than doubled from $5.2 billion to $10.9 billion. Following the absence of a single billion-dollar foreign issuer offering in 2005—for the first time in over 10 years—2006 saw two billion-dollar foreign offerings on US exchanges. Median deal size by foreign issuers increased 77%, from $113.1 million to $200.0 million.

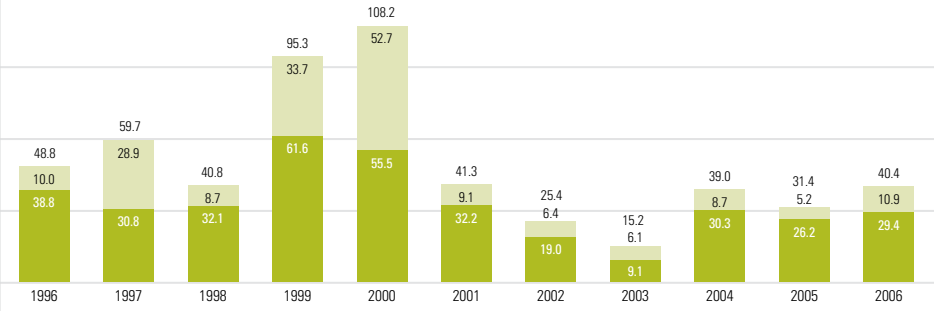
The energy-related industry sector led the IPO market for the second consecutive year with 30 IPOs, or 15% of the total—up slightly from 26 IPOs (14% of the total) in 2005. Other leading sectors were financial services with 25 IPOs (13%), biotechnology/pharmaceutical companies with 24 IPOs (12%), and consumer products and services with 22 IPOs (11%).

US IPOs – 1996 to 2006



Source: SEC filings

US IPO Dollar Volume – 1996 to 2006



Source: SEC filings

The number of IPOs by technology-related companies increased 11%, from 77 in 2005 (41% of the total) to 84 in 2006 (42% of the total). Gross proceeds raised by tech-related companies were unchanged, with $9.9 billion in 2006 (25% of the total) compared to $9.9 billion in the prior year (31% of the total).

Venture-backed IPO activity also improved in 2006. The number of venture-backed IPOs increased 33%, from 42 in 2005 to 56 in 2006, and their gross proceeds increased 65%, from $2.26 billion to $3.72 billion.

The percentage of profitable companies going public increased from 62% in 2005 to 64% in 2006—the second highest annual percentage in over 10 years—in sharp contrast to the 26% in both 1999 and 2000. The median annual revenue of IPO companies increased from $105.9 million to $111.1 million. When the IPO market was its most selective (between 2001 and 2003), the median annual revenue of IPO companies averaged $168.5 million.

The capital markets posted solid gains in 2006 despite mid-year dips—which contributed to a low level of IPO activity in the already historically light summer months—with the Dow gaining 16.3% and the Nasdaq up 9.5%. The average 2006 IPO outperformed the market, ending the year 24% above its offering price, with 40% of this gain attributable to first-day performance. On a quarterly basis, the 30 IPOs in the third quarter posted the highest average gain for the year at 38%.

At year-end, 70% of 2006 IPOs were trading at or above their offering price—40 deals were up more than 50% and 15 had doubled in price. The best performing IPO of 2006 was Riverbed Technology (a developer of optimized wide-area data services solutions), which ended the year 215% above its offering price. Other impressive year-end gains were produced by Chinese economy hotel chain Home Inns & Hotels Management (up 172%), Acorda Therapeutics—a developer of drugs for the treatment of spinal cord injuries and multiple sclerosis—(up 164%), Chipotle Mexican Grill (up 159%) and MasterCard (up 153%).

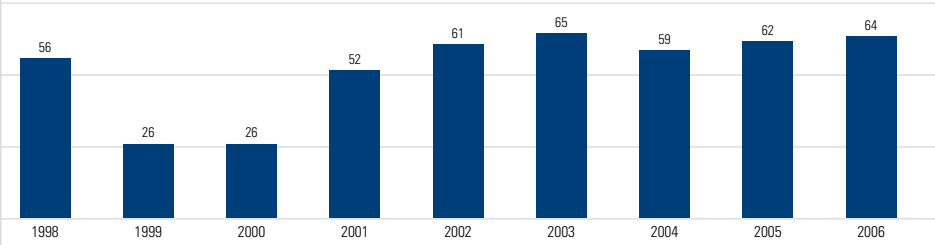
Two of the year's IPOs ended their opening day up at least 100% from their offering price—led by the 125% first-day gain by securities exchange company NYMEX—and seven additional companies saw their stock price increase at least 50% on the first day of trading.

The best performing IPO sectors of 2006 were consumer products and services, whose 22 IPOs gained an average of 35% by year-end, and business/industrial services, whose 12 IPOs also increased 35% on average by year-end. Close behind were financial services companies, with an average annual gain of 33%.

In 2006, 82 IPOs (41% of the total) were completed by companies based in the eastern United States (east of the Mississippi River) while western US-based issuers accounted for 81 IPOs (41% of the total), with foreign issuers accounting for the remaining 35 IPOs (18% of the total). Eastern US IPOs raised $15.0 billion (37% of the total), western US IPOs raised $14.4 billion (36%) and foreign issuer IPOs raised $10.9 billion (27%) of the year's IPO proceeds.

Percentage of Profitable IPO Companies – 1998 to 2006

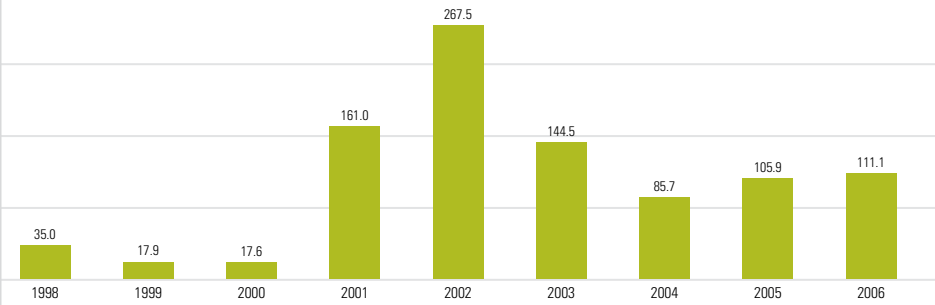
%



Source: IPO Vital Signs

Median Annual Revenue of IPO Companies – 1998 to 2006

$ millions



Source: IPO Vital Signs

California maintained its dominant position in the IPO state rankings with 35 IPOs, followed by Texas with 20 (buoyed by a steady flow of energy-related IPOs), New York with 19 and Massachusetts and Pennsylvania with nine each.

State Rankings – 2000 to 2006

California	303
New York	81
Texas	77
Massachusetts	69
Illinois	40
Pennsylvania	40

China posted the most foreign issuer IPOs (eight—although down from nine in 2005), followed by Bermuda (four) and Canada, Greece and Israel (three each).

Foreign Country Rankings – 2000 to 2006

China	41
Israel	28
Bermuda	25
Canada	23
England	11
Greece	11

The percentage of IPO companies listing on the Nasdaq—the preferred listing choice for many venture-backed and technology companies—increased from 63% in 2005 to 65% in 2006. Average IPO offering size for companies listing on the Nasdaq increased from $92.7 million to $124.7 million, while average IPO offering size for companies listing on the NYSE climbed from $340.4 million to $387.4 million.

2007 Outlook

The US IPO market of the past 15 years has gone through four phases:

- 1991 to 1997 – Reasonably stable market, producing an average of more than 500 IPOs per year
- 1998 to mid-2000 – Go-go market characterized by many unqualified IPO companies and rampant price euphoria (although deal volume was about 25% lower than in the preceding seven years)
- 2001 to mid-2003 – Very selective market, in which deal volume fell to historic lows and IPO candidates were held to much higher standards
- Mid-2003 through 2006 – Solid market recovery, although not approaching the deal volumes that prevailed for most of the 1990s

Viewed through this lens, the IPO market of the late 1990s was as aberrant as the market that immediately followed it. We expect the 2007 IPO market to produce a steady stream of new offerings, with a deal volume closer to that of the past three years than to that of the 1990s. A number of factors will influence the market this year:

Capital Market Conditions

Stable and robust capital markets are a leading indicator of IPO activity. In 2006, both the Dow and Nasdaq produced solid returns after flat performances in 2005, and the Dow ended the year just shy of its all-time high. Market performance in 2006 surprised many analysts, and has left observers cautiously optimistic about 2007's prospects.

Economic Growth

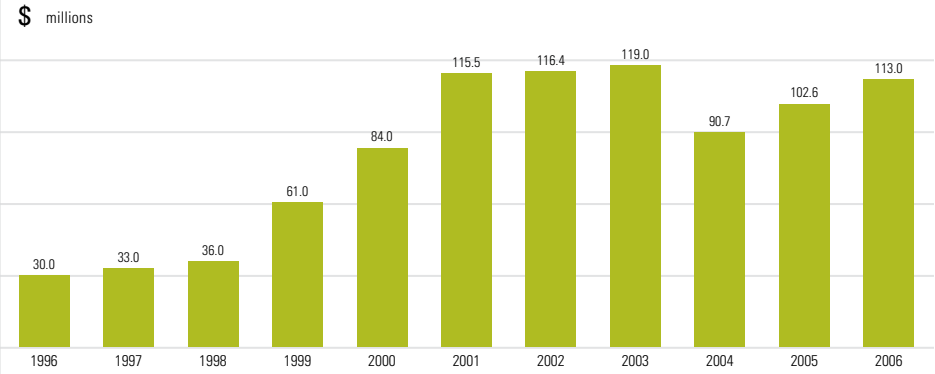
Economic growth is a key determinant of strength in the capital markets. After the technology-fueled boom sputtered to an end in early 2001, economic recovery was largely driven by strong consumer spending, boosted by low interest rates, tax cuts and increased borrowing against home equity as housing values soared. Entering 2007, the consensus appears to be that the United States is in a "Goldilocks" economy—not too hot and not too cold—which should be conducive to economic growth, although, as always, analysts are watching the warning signs:

- Interest rates, although still low by historical standards, have increased significantly since hitting a 45-year low in mid-2004
- Petroleum prices, despite retreating from mid-year highs, increased again in 2006
- Capital spending and employment growth have slowed
- Further softening of the housing market could crimp consumer spending and slow economic growth
- The persistence of some core inflation
- The expense of the continuing military conflict in Iraq

Regulatory Environment

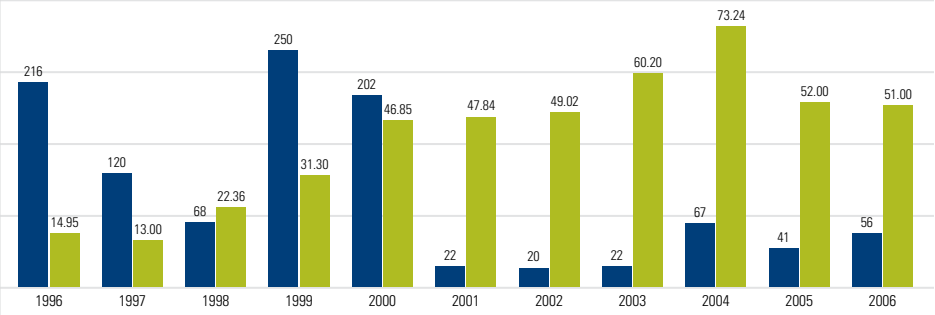
Corporate governance reforms in the United States have created new responsibilities for public companies and their directors and officers. These changes have helped improve accountability

Median IPO Offering Size – 1996 to 2006



Source: SEC filings

Venture Capital–Backed IPOs – 1996 to 2006



Source: Dow Jones VentureOne

to stockholders, board oversight of management, board member qualifications and investor confidence—but have also increased the cost of being public, both in terms of potential liability and the expense of compliance.

In the near term, the new corporate governance environment may deter some IPO candidates, steer them to liquidity through acquisitions or incent them to pursue IPOs in markets outside of the United States—since 2002, IPO deal volume has grown more rapidly on the London Main and AIM exchanges than Nasdaq and NYSE, and in 2006 the United States slipped behind both Europe and Asia in the worldwide IPO market. However, in the longer term, we believe that corporate governance changes will be assimilated into IPO planning and not pose a major impediment for most companies wishing to pursue IPOs in the United States.

Nature of IPO Candidates

There is no single profile of a successful IPO company, but we expect that most IPO candidates in 2007 will have:

- Experienced management
- A superior technology or product position in a large and growing market
- Substantial revenue—at least $50–$75 million annualized
- Strong revenue growth—25% or more annually
- Profitability—historical or, in some cases, imminent
- Potential market capitalization of at least $150–$200 million

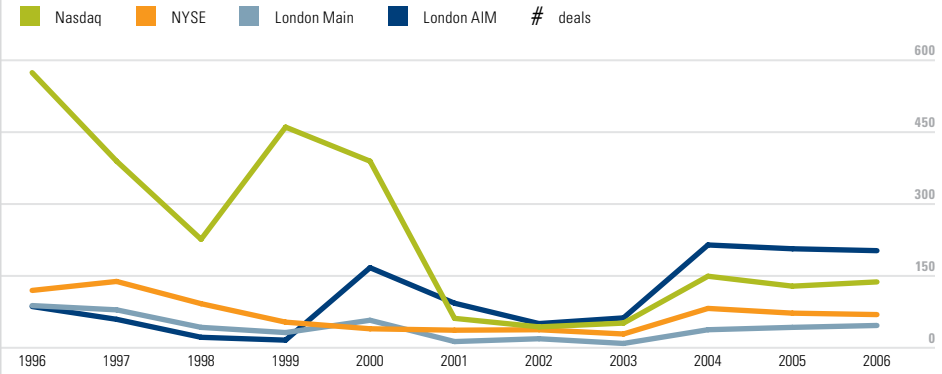
These factors can vary widely based on a company's industry and size. For example, most biotech companies will have much smaller revenue and not be profitable. More mature companies are likely to have greater revenue and market caps but slower growth rates.

Venture Capital Pipeline

According to Dow Jones VentureOne, at the end of 2006 there were 26 VC-backed companies in IPO registration—up from 20 at the end of 2005. Of these 26 VC-backed companies, eight were engaged in biopharmaceuticals, five were software companies, four were communications and networking companies, four were providers of medical devices or healthcare, three offered business or consumer services, and there was one specialty retailer and one semiconductor company.

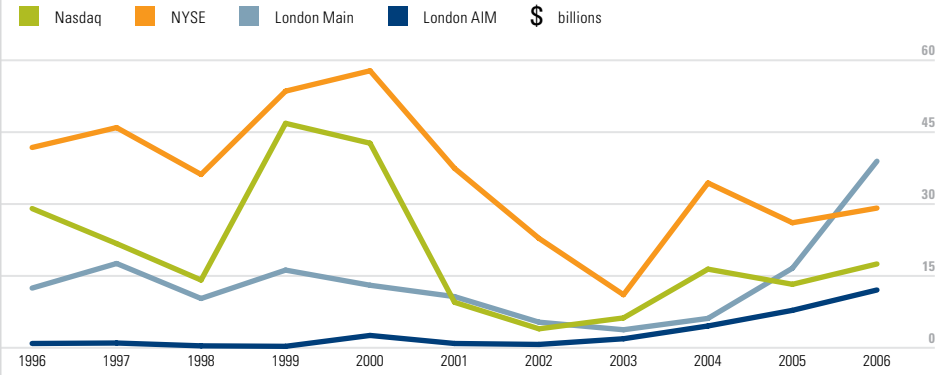
Longer term, the pool of IPO candidates will be affected by current trends in venture capital investing, including the timeline from initial funding to IPO. According to Dow Jones VentureOne, while the median amount invested from initial equity financing to IPO was largely unchanged between 2005 ($52 million) and 2006 ($51 million), the time from initial equity financing to IPO increased from 5.6 years in 2005 to 6.2 years in 2006.

IPOs by Exchange – 1996 to 2006



Source: Thomson Financial

IPO Dollar Volume by Exchange – 1996 to 2006

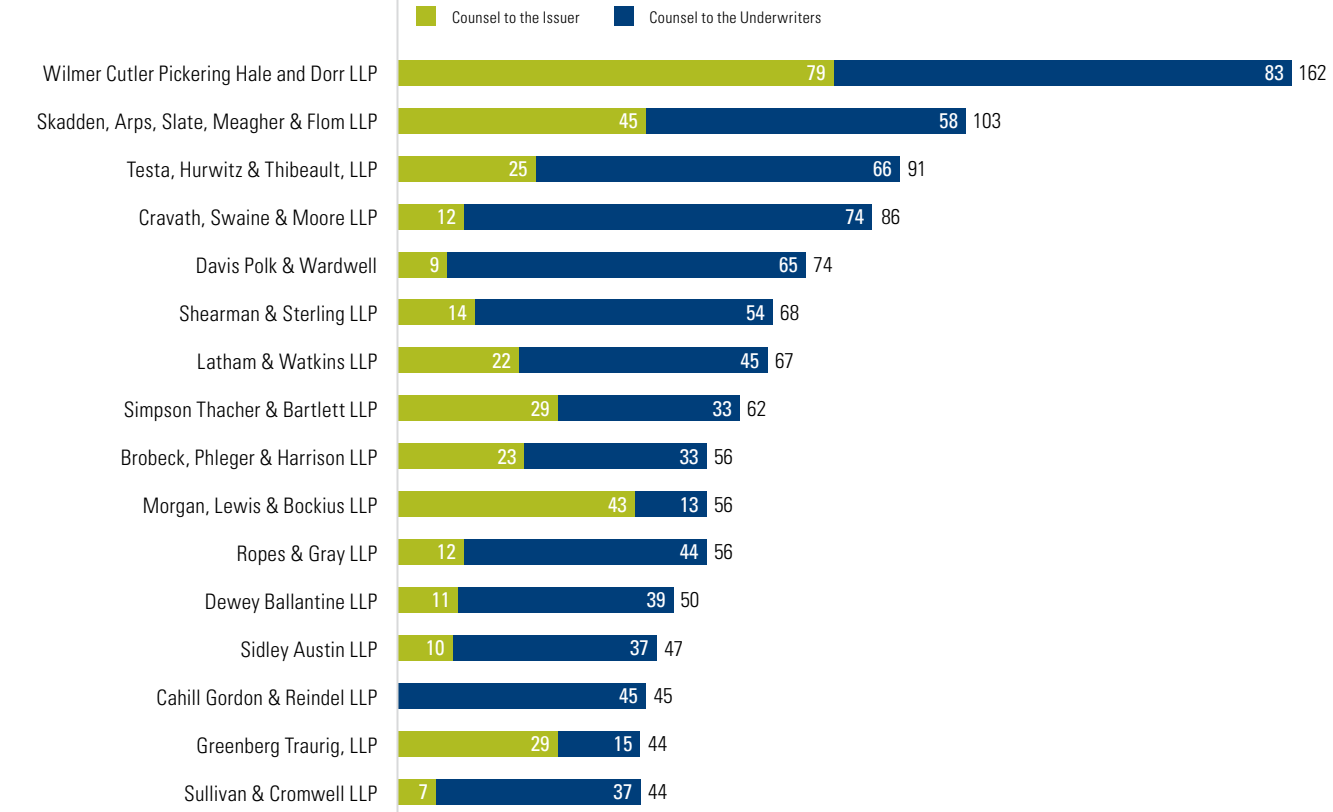


Source: Thomson Financial

Private Equity Impact

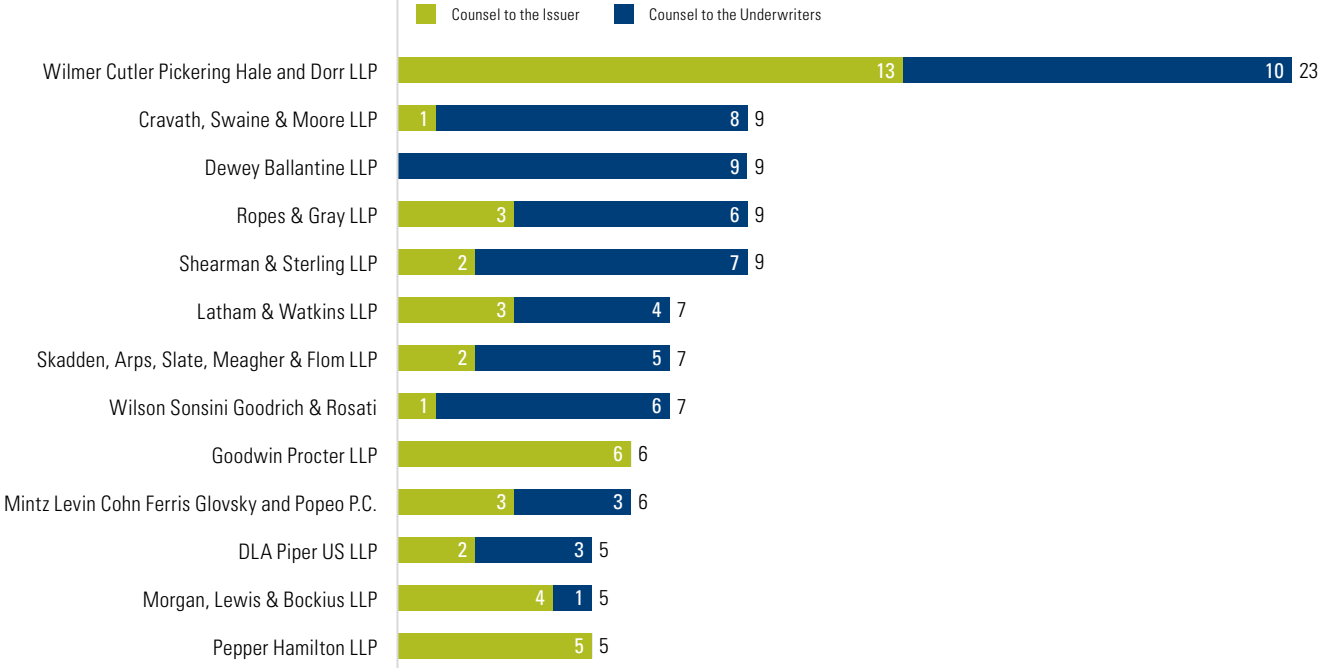
As do venture capitalists, private equity investors seek to divest portfolio companies or achieve liquidity through IPOs. PE-backed companies are usually much larger and more seasoned than VC-backed companies or other start-ups pursuing IPOs, and thus can be strong candidates in a demanding IPO market, and their IPOs are often very large—half of all billion-dollar-plus IPOs in 2006 were by private equity–backed companies. The ongoing surge in private equity investment activity should continue to generate viable IPO candidates in 2007. ■

Eastern US IPOs – 1996 to 2006



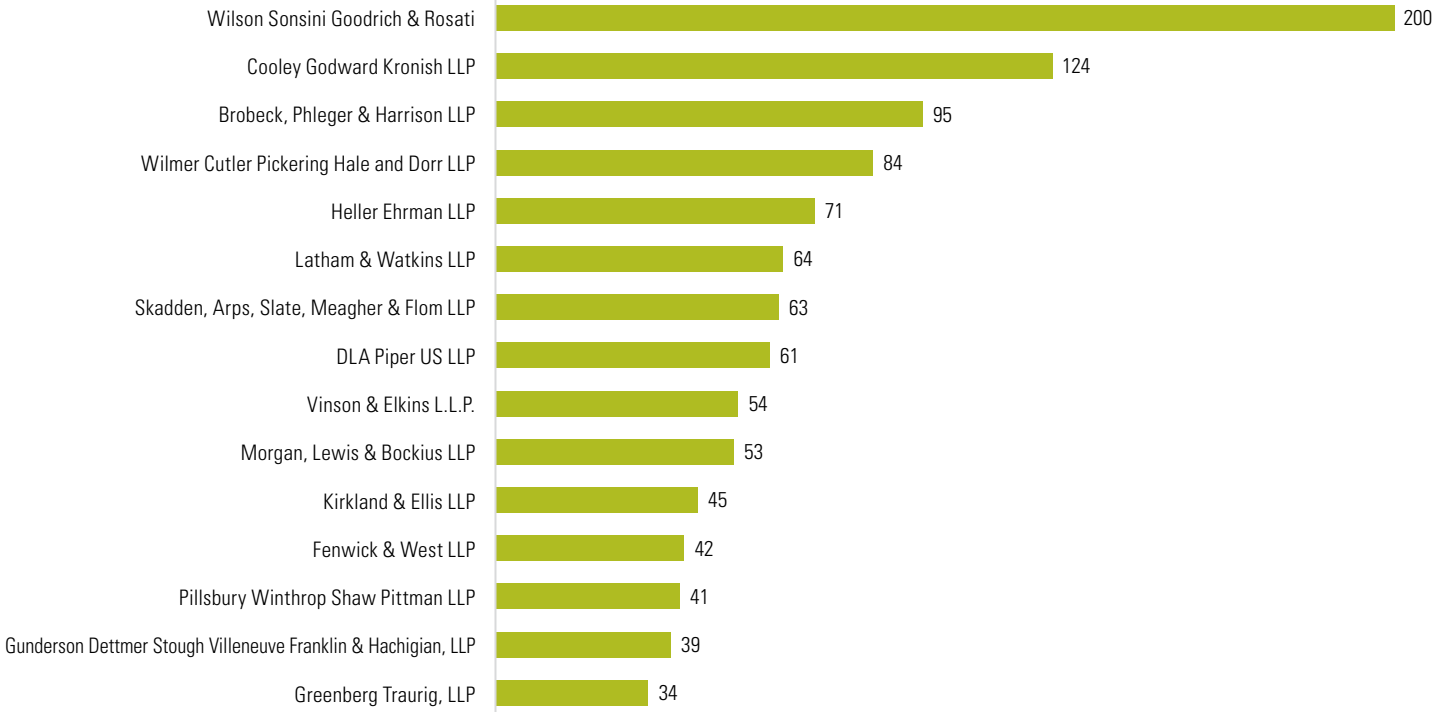
Source: SEC filings

Eastern US Technology Company IPOs – 2004 to 2006



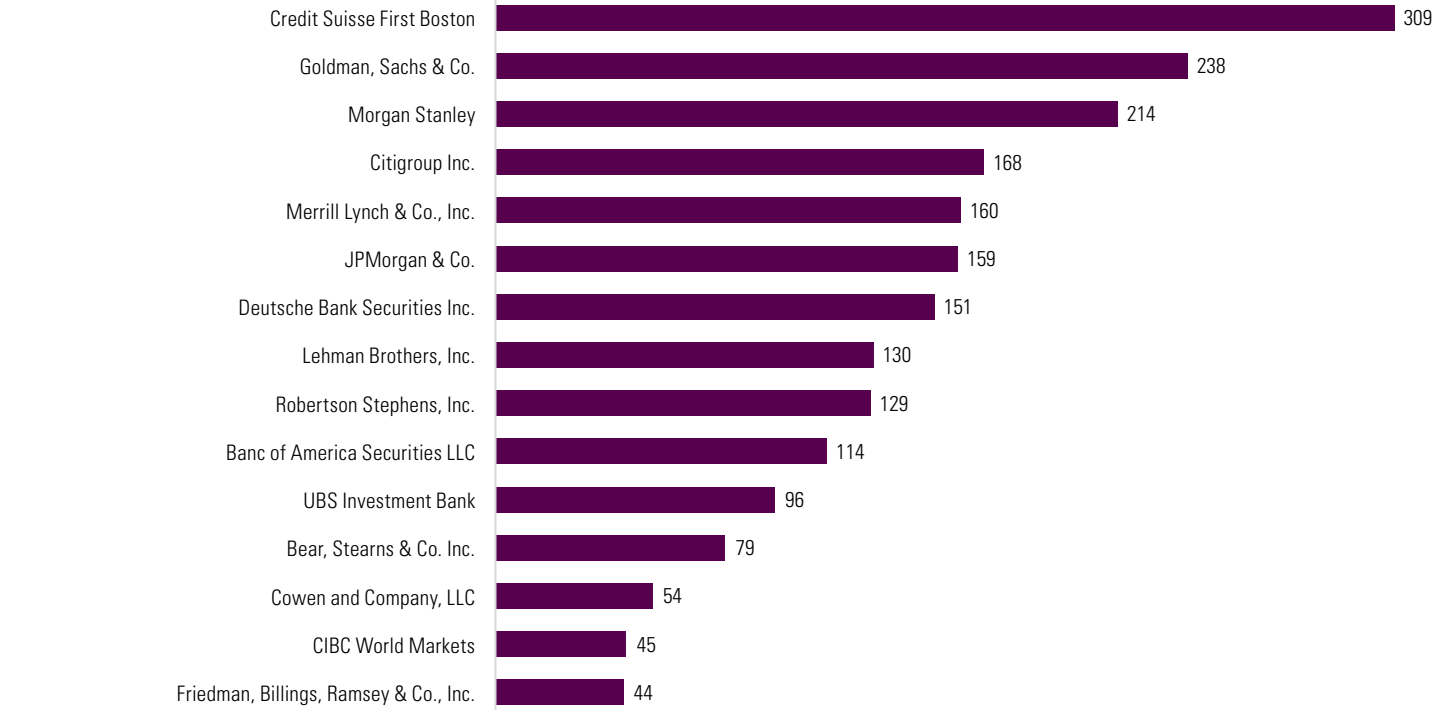
The above charts are based on companies located east of the Mississippi River.
Source: SEC filings

Issuer Counsel in US IPOs – 1996 to 2006



Source: SEC filings

Lead Underwriter in US IPOs – 1996 to 2006



The above charts are based on IPOs by US-based companies.
Source: SEC filings

California

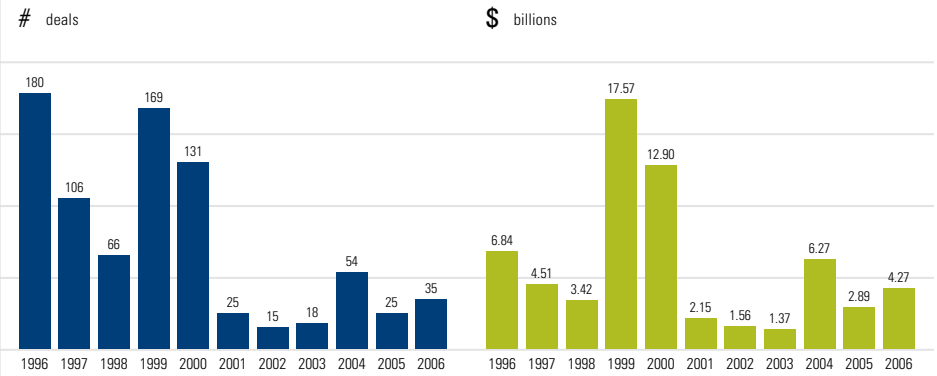
California produced 35 IPOs with gross proceeds of $4.27 billion in 2006. These results reflect increases of 40% in deals and 48% in gross proceeds from 2005, but remain well below the levels of IPO activity between 1996 and 2000, when California averaged 130 IPOs and $9.05 billion in gross proceeds annually.

The California IPO market remains dominated by technology-related companies, with 27 tech IPOs accounting for 77% of the total number of offerings in 2006. Both tech and non-tech IPOs in California underperformed the market in 2006. The average California tech IPO ended the year 18% above its offering price, compared to the national average of 24%. Non-tech IPOs in California increased 7% on average, compared to an average gain of 25% for all non-tech IPOs nationwide.

While the perceived heavy burdens of public company compliance and an active M&A market for venture-backed companies appear to continue to restrain IPO growth, the uptick in IPO activity in 2006 suggests that the market is becoming more accustomed to the new regulatory regime. We believe it also reflects the strength and resiliency of overall capital markets, increasing private equity buyout investment activity and resultant portfolio company exits, a highly active venture capital investment climate, and stable earnings growth by more venture-backed companies in recent years.

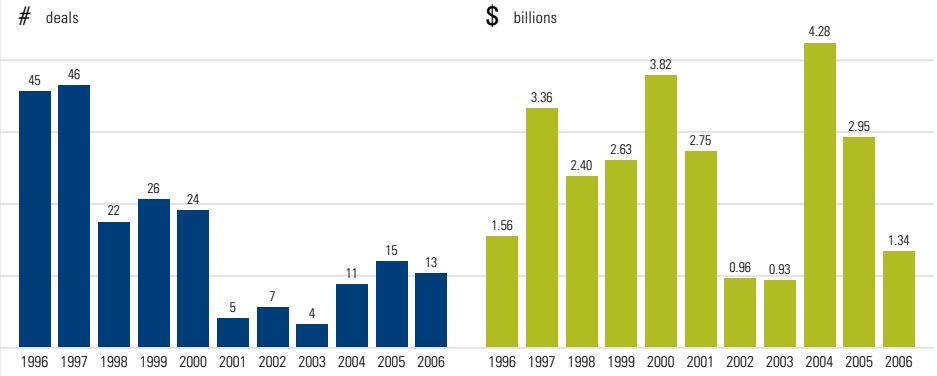
Although there is always the possibility of a market correction, we believe that California IPO activity will continue to trend upward as regulatory reform progresses, more emerging companies demonstrate strong revenue and profitability, and newer markets—such as biotechnology, clean energy technology, wireless applications and services, and cross-border US/Asia deals—expand and mature.

California IPOs – 1996 to 2006



Source: SEC filings

Mid-Atlantic IPOs – 1996 to 2006



Source: SEC filings

Mid-Atlantic

The mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia produced 13 IPOs with gross proceeds of $1.34 billion in 2006, down from 15 IPOs with gross proceeds of $2.95 billion in 2005.

Maryland led the region with five IPOs in 2006, followed by Virginia with four. There were 10 technology-related IPOs in the mid-Atlantic region in 2006, representing 77% of the total, up from seven (47%) in 2005 and five (45%) in 2004, demonstrating the region's increasing importance as a center for life sciences companies. Half of the tech-related IPOs were by biopharmaceutical companies—the largest of which was Emergent BioSolutions' $62.5 million offering—and another major IPO came from healthcare IT company Visicu ($110.4 million). The average mid-Atlantic tech IPO ended the year up 32% from its offering price, compared to an increase of only 7% for the average non-tech IPO in the region.

In 2007, we expect the region's IPO candidates to include additional life sciences companies, as well as government-related IT services and defense companies. We also anticipate offerings by software and wireless companies.

New England

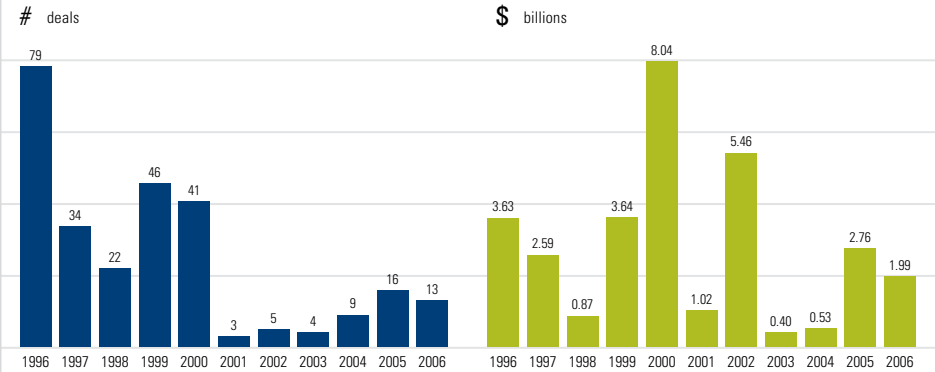
New England produced 13 IPOs with $1.99 billion in gross proceeds in 2006, compared to 16 IPOs and $2.76 billion in gross proceeds in 2005. Although deal flow retreated from 2005 levels, the region's results in 2006 easily topped IPO activity in the 2001–2003 period, which produced an annual average of only four IPOs.

Massachusetts contributed the lion's share of New England's IPOs in 2006 (nine of the 13). New England retained its high concentration of technology-related IPOs with seven (54% of the region's total), but in a departure from the past, it also produced four IPOs in the financial services and insurance sectors. More than half of the tech-related IPOs were by biotech or medical device companies—of these, the largest was the $120.8 million offering from Altus Pharmaceuticals, and the best performing was Achillion Pharmaceuticals' IPO, which ended the year 40% above its offering price.

The average New England tech IPO ended the year up 38% from its offering price, while the average non-tech IPO in the region increased 18%. The top-performing New England IPO of 2006 was Acme Packet, up 117% from its offering price.

We expect that continued strong levels of venture capital investment in New England, along with the region's world-renowned universities and research institutions, will continue to provide a fertile environment for new companies and IPO candidates. In 2007, we anticipate a steady flow of IPOs from technology and life sciences companies based in New England—Massachusetts in particular—so long as market conditions remain conducive.

New England IPOs – 1996 to 2006

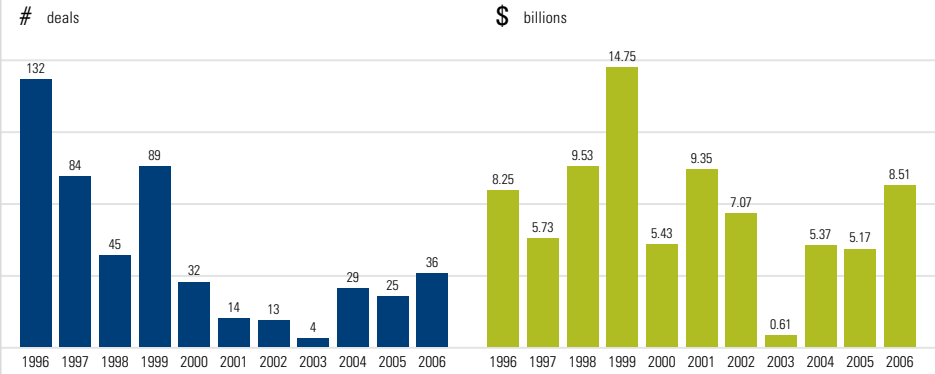


Source: SEC filings

Tri-State

In 2006, the tri-state region of New York, New Jersey and Pennsylvania generated 36 IPOs, a 44% increase from 25 offerings in 2005, for gross proceeds of $8.51 billion (up 65% from $5.17 billion the prior year). The region's strong IPO performance in 2006 was its best overall since 1999—the last full year of the dot-com boom.

Tri-State IPOs – 1996 to 2006



Source: SEC filings

The tri-state region produced 12 IPOs by financial services companies and another eight from the consumer/retail sector (traditional strengths for this region), including companies in the restaurant, hospitality, fitness, apparel and rental car businesses. The region also saw 11 IPOs in various technology sectors, including biopharmaceuticals, healthcare, communications, e-commerce, software and IT outsourcing. The average tech IPO in the tri-state region ended the year up 36% from its offering price, while the average non-tech IPO in the region increased 31%.

Venture capital activity in the tri-state region now trails only that of California and New England. We expect that the region's VC-backed companies—including technology and life sciences companies—as well as spinoffs from the region's established companies, will continue to produce a healthy crop of IPO candidates in 2007. ■

In December 2005, the SEC issued rules that significantly reformed the manner in which companies going public can communicate with investors during the IPO process. Due to the nature of the reforms, it was clear that it would take time for law firms, underwriters and accounting firms to establish standard methodologies to implement the new rules. With the benefit of market experience gained in 2006, IPO issuers should revisit those rules in order to avoid delays or surprises during the IPO process.

Pre-Filing Communications

Section 5 of the Securities Act generally prohibits "offers" until a registration statement is on file with the SEC, in order to ensure that the filed prospectus is the primary source of investors' information about a registered offering. Historically, a company planning an IPO had to cautiously monitor the issuance of all public communications throughout an undefined period preceding the initial filing of its registration statement to avoid a claim that it was conditioning the market prior to the IPO—a situation known as "gun-jumping." If an issuer violates the gun-jumping rules, its IPO may be delayed for a "cooling off" period and the issuer may be required, for a period of one year following the violation, to repurchase the IPO shares at the IPO price.

New Rule 163A establishes a broad exemption from gun-jumping restrictions for communications made more than 30 days prior to the filing of an IPO registration statement. This safe harbor applies if:

- a communication is made by or on behalf of the issuer;
- the communication does not reference the IPO; and
- the issuer takes reasonable steps to prevent the communicated information from being further distributed after the safe harbor period ends.

The number of gun-jumping incidents reported in IPO registration statements declined in 2006, although that drop may have resulted less from Rule 163A than from heightened awareness of the issue as a result of highly publicized gun-jumping violations by Google and salesforce.com.

In relying upon Rule 163A, IPO issuers should remember:

- Although a press interview given more than 30 days before filing is exempt, Rule 163A will not protect a resulting article that is published after the safe harbor period ends. Pre-offering press opportunities should be approached cautiously, since issuers typically will be unable to control the content and timing of the resulting publications.
- Exempt communications need not be removed from an issuer's website, but should be dated clearly and designated as "archived" or "historical" information.

Factual Business Communications

New Rule 169 enables an IPO issuer to continue to disseminate regularly released, ordinary course information both prior to and during the IPO registration process. This safe harbor applies to a communication that:

- consists of factual information about the issuer, its business or its financial developments, or advertisements and other information concerning the issuer's products or services;
- is of a type regularly released by the issuer in the ordinary course of business;
- does not include information about, or released in connection with, the IPO; and
- is intended for use by persons, such as customers or suppliers, other than potential investors.

In relying upon Rule 169, an IPO issuer should note:

- For continuity, those employees who historically have been responsible for providing the issuer's factual business information should continue to do so during the IPO.
- Rule 169 will not protect forward-looking information, such as future plans and objectives, or information released at an investor conference.

Limited Notices of Offering

Historically, Rule 134 provided issuers with a safe harbor under which they could, at any time after filing a registration statement, disseminate narrowly prescribed types of information to inform potential investors how to obtain a copy of a preliminary or final prospectus. Under the offering reforms, a Rule 134 notice may include additional information about:

- the issuer and its business, including the issuer's contact information;
- the underwriters and their roles within the underwriting syndicate;
- the IPO timetable, other IPO marketing events and other aspects of the offering;
- mechanics for purchasing the offered common stock; and
- procedures for directed share programs and other processes by which officers, directors and employees may participate in an IPO.

A Rule 134 notice must still exclude price and price-related information until a bona fide price range has been disclosed in the IPO registration statement.

In general, the content of Rule 134 press releases issued by IPO companies in 2006 did not change markedly from earlier practice.

- Typically, there is little reason for an IPO issuer to provide more than a brief paragraph describing its business in a Rule 134 press release. The purpose of the press release is still to encourage the investor to obtain a prospectus for detailed information about the issuer and its IPO.
- IPO issuers should confirm that their investment banks are complying with Rule 134 when circulating notices regarding directed share programs and roadshow schedules.

Free Writing Prospectuses

New Rule 433 permits issuers to make offers of securities by written communications, including electronic communications, in addition to a preliminary or final prospectus. These written communications, known as "free writing prospectuses" or "FWPs," provide issuers with a means of updating

or correcting information during an offering without the inconvenience, expense or potential stigma associated with re-circulating a new preliminary prospectus. FWPs may take any form and are not required to meet the informational requirements otherwise applicable to prospectuses. An FWP must:

- in most instances, be filed with the SEC;
- in certain instances, be accompanied or preceded by the most recent prospectus;
- not be materially misleading;
- not contain information that conflicts with the prospectus; and
- contain a legend regarding the prospectus.

Pre-Pricing FWPs. In 2006, several IPO companies circulated FWPs during their roadshows to disclose issuer-related information such as new litigation and regulatory proceedings, newly available financial data, recently executed contracts and inadvertently omitted risk factors. Pre-pricing FWPs also were used to update deal-related information—for example, by revising the intended use of proceeds, updating the beneficial stock ownership table and identifying new managing underwriters.

An IPO issuer should:

- work with its counsel to prepare a pre-pricing FWP to convey any information that the issuer believes is necessary to make the offering disclosures complete and correct; and
- discuss with its underwriters in advance the process by which any required FWPs will be circulated to potential investors—for example, email delivery may not be feasible if an IPO is being marketed to retail investors.

Pricing-Related FWPs. Many 2006 IPO issuers used FWPs to convey IPO pricing information—such as the share price, the underwriting discount and the size of the offering—most frequently when downsizing an offering or pricing below the estimated price range.

An IPO issuer should:

- consider including a "sensitivity analysis" in its preliminary prospectus to indicate how price-related information (e.g., estimated net proceeds, dilution and "as adjusted" financial data) would change if the actual price were to differ from the mid-point of the estimated price range—in most cases, this type of analysis will enable the issuer to avoid updating all of the price-related information in the final FWP;
- minimize the amount of information that needs to be conveyed at the time of sale by providing as much updating information as possible in pre-pricing FWPs; and
- if pricing information is to be provided orally rather than in an FWP, have a clear understanding with its underwriters of the precise message that will be conveyed telephonically by brokers to investors.

Roadshows

Roadshows are a critical component of any IPO. The offering reforms clarified the ground rules for live roadshows and simplified the requirements applicable to electronic roadshows.

Live Roadshows. As a basic rule, in-person, live roadshows are considered oral communications. If, however, any portion of a live roadshow is recorded for rebroadcast or transmission, it will be considered a written communication and typically will constitute an FWP that must meet the requirements of Rule 433 described above.

Slides and visual aids that are transmitted simultaneously with a live roadshow, but are not available separately, are deemed part of the roadshow and treated in the same manner as the roadshow itself. If visual aids are available separately, they will be treated as a written communication and typically will constitute an FWP.

Electronic Roadshows. Under Rule 433, electronic roadshows, which are transmitted over the Internet or a private network, are considered written communications and, therefore, FWPs. An issuer that elects to use an electronic roadshow in connection with its IPO must either file the text of the roadshow with the SEC or post a "bona fide" version of the electronic roadshow on its website, together with an active hyperlink to a preliminary prospectus that includes a price range.

A bona fide version of an electronic roadshow:

- is a written communication that was transmitted by any form of electronic media;
- contains a presentation by management; and
- if the issuer is using or conducting more than one roadshow that is a written communication, includes discussion of the same general areas of information as the other "written" roadshows.

To be considered bona fide, the version need not be identical to other roadshows or address all of the same subjects, and need not provide an opportunity for questions and answers even if the other roadshows provide such an opportunity.

In 2006, most IPO companies using electronic roadshows elected to post them to their websites rather than file the text of the roadshows with the SEC. ■

Public Availability of SEC Comment and Response Letters

In a move unrelated to the offering reforms, in late 2004, the SEC began to publicly release the comment letters and issuer responses from the registration statement review process. Correspondence is posted no sooner than 45 days after the SEC's review of the registration statement has been completed. These letters, which previously were available only through a Freedom of Information Act request, can now be found on the SEC's EDGAR system.

This change has several important consequences:

- Posted comment letters can help an IPO issuer and its counsel understand and anticipate the types of comments that may be received in the SEC review process.
- Regardless of whether a company is involved in an IPO, posted comment and response letters relating to competitors' offerings may be a source of useful information.
- Issuers should seek confidential treatment of portions of response letters that contain market-sensitive or competitive information.

Counsel of Choice for Public Offerings

SERVING INDUSTRY LEADERS IN TECHNOLOGY, LIFE SCIENCES, FINANCIAL SERVICES, COMMUNICATIONS AND BEYOND

Initial Public Offering of Common Stock	*Public Offering of Common Stock*	*Public Offering of 0.25% Convertible Senior Notes due 2013*	*Public Offerings of Medium-Term Notes*	*Initial Public Offering of Common Stock*	*Public Offering of Common Stock*	*Rule 144A Placement of 1.50% Convertible Senior Notes due 2011 and 1.625% Convertible Senior Notes due 2013*	*Initial Public Offering of Common Stock*	*Public Offering of 6.150% Senior Notes due 2036*
$380,525,000	**$230,000,000**	**$300,000,000**	**$16,350,216,000**	**$59,512,500**	**$148,350,000**	**$4,400,000,000**	**$101,200,000**	**$250,000,000**
Counsel to Issuer	Counsel to Issuer	Counsel to Underwriters	Counsel to Underwriters and Agents	Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer
June 2006	**November 2006**	**April 2006**	**Various Dates 2006**	**October 2006**	**November 2006**	**April 2006**	**May 2006**	**November 2006**

Public Offering of Common Stock	*Initial Public Offering of Common Stock*	*Initial Public Offering of Common Stock*	*Initial Public Offering of Common Stock*	*Initial Public Offering of Ordinary Shares*	*Initial Public Offering of Common Stock*	*Public Offerings of Common Stock*	*Initial Public Offering of Common Stock*
$62,504,500	**$95,392,500**	**$146,625,000**	**$116,584,000**	**£50,000,000**	**$120,750,000**	**$165,917,000**	**$45,000,000**
Counsel to Issuer	Counsel to Underwriters	Regulatory Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters
January 2006	**August 2006**	**November 2006**	**October 2006**	**February 2006**	**January 2006**	**February and December 2006**	**April 2006**

Initial Public Offering of Common Stock	*Public Offering of 5.75% Notes Due 2017*	*Public Offering of Common Stock*	*Initial Public Offering of Common Stock*	*Public Offering of 2.25% Convertible Subordinated Notes due 2013*	*Initial Public Offering of Common Stock*	*Public Offering of Common Stock*	*Public Offering of Common Stock*	*Public Offering of 2.25% Convertible Senior Notes due 2011*
$62,500,000	**$250,000,000**	**CHF 96,541,500**	**$110,400,000**	**$350,000,000**	**$25,525,000**	**$414,000,000**	**$60,793,600**	**$250,000,000**
Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters	Counsel to Underwriters	Counsel to Issuer
November 2006	**September 2006**	**March 2006**	**April 2006**	**June 2006**	**November 2006**	**March 2006**	**December 2006**	**October 2006**

Initial Public Offering of Common Stock	*Initial Public Offering of Common Stock*	*Exchange Offer for 11 3/4% Senior Subordinated Notes due 2013*	*Public Offerings of Preferred Stock*	*Public Offering of 1.5% Convertible Bonds due 2013*	*Public Offering of Common Stock*	*Public Offering of Common Stock*	*Public Offering of 7.000% Senior Notes due 2016*
€17,480,000	**$38,500,000**	**$205,000,000**	**$94,600,000**	**CHF 132,500,000**	**$45,500,000**	**$56,336,000**	**$500,000,000**
Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Underwriters	Counsel to Issuer	Counsel to Issuer	Counsel to Issuer	Counsel to Issuer
May 2006	**October 2006**	**September 2006**	**June and August 2006**	**March 2006**	**November 2006**	**June 2006**	**May 2006**

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IPO companies often struggle with the loss of confidentiality that results from becoming subject to public company disclosure requirements. Companies going public are concerned, for example, that disclosures made for the benefit of new stockholders will be used to the company's disadvantage by customers, suppliers and—worst of all—competitors.

One of the most sensitive areas of concern, however, is centered around a different audience: the company's employees. IPO companies wonder and worry about how their corporate culture will be affected once employees can see detailed information about the compensation of the company's top executives.

The SEC recently implemented new disclosure rules that place a stronger spotlight on executive compensation. These rules reemphasize the historical concerns about loss of secrecy and require that an IPO company's management devote more time and attention to compensation matters than was previously required.

Overview of New Rules

Effective for fiscal years ending on or after December 15, 2006, the SEC has adopted far-reaching changes to its disclosure rules addressing executive and director compensation, related person transactions, director independence, other corporate governance matters, and director and officer stock ownership. The new rules apply to IPO registration statements, as well as proxy statements and Forms 10-K for existing public companies.

These rules are intended to provide investors with a more clear and complete picture of executive compensation, and an understanding of key financial relationships among companies and their executive officers, directors and significant shareholders. They are principles-based and designed to eliminate the age-old question: "Where does it say we have to disclose that?"

The key changes relating to executive and director compensation are:

Expanded Tabular Presentation and Related Narrative. The new rules require a broad-based tabular presentation of compensation information, with additional narrative supplementing the tables. These rules expand the scope of the previously required tables in order to prevent any compensation items from slipping between the cracks. For example, where the old rules tended to focus on disclosures regarding stock options, the new rules more generally require disclosure regarding all equity awards.

A revised Summary Compensation Table—which continues to serve as the primary vehicle for disclosing executive compensation—now includes a column disclosing the dollar amount of total compensation paid to each of the company's named executive officers (NEOs). The new rules also call for a supplemental table (the Grants of Plan-Based Awards Table) disclosing information about grants of plan-based awards, whether they involve equity or cash. Narrative disclosure must follow both of these tables, in order to provide any additional material information necessary to understand the tabular information.

Four additional executive compensation tables are now required to the extent applicable to the company:

- Outstanding Equity Awards at Fiscal Year-End
- Option Exercises and Stock Vested
- Pension Benefits (including supplemental narrative)
- Nonqualified Deferred Compensation (including supplemental narrative)

Another new table requires, for the first time, that all compensation paid to directors be captured in a single Director Compensation table.

The column headings for the seven new tables are presented below.

Also called for in the new rules is disclosure regarding compensation arrangements triggered upon termination of employment or changes in control. While this disclosure must be quantitative, it does not have to be presented in a table.

Compensation Discussion and Analysis. The rules require a new Compensation Discussion and Analysis (CD&A) section that provides, in narrative form, an overview of the material elements of

The New Tabular Disclosures

The SEC's new compensation disclosure rules require both a principles-based, narrative discussion and tabular disclosure using a prescribed format. Tabular disclosure continues to be an important aspect of the SEC's rules, in part because the tables facilitate comparisons between years and among companies. The column headings for the new compensation disclosure tables are presented below. While these headings generally cannot be altered, empty columns and inapplicable tables can be omitted.

Summary Compensation Table									
Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)

a company's compensation of its NEOs and material information about compensation objectives and policies for NEOs. For existing public companies, the CD&A essentially replaces and expands the report on executive compensation previously required of the compensation committee.

CD&A will appear at the beginning of the executive compensation disclosure and is analogous to the overview section of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The disclosure required in CD&A is principles-based, identifying generally what is to be disclosed (that is, the compensation awarded to, earned by or paid to the NEOs). In adopting the new rules, the SEC provided illustrative examples of topics that might be appropriate to address in CD&A (see page 17). The specific application of CD&A requirements is, however, left to the facts and circumstances of each company. Without resorting to boilerplate or merely repeating the tabular information, the discussion should focus on the material principles underlying the company's executive compensation policies and decisions, and the factors most important to an analysis of those policies and decisions. CD&A should answer the following questions:

- What are the objectives of the company's compensation program?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount or formula for each element?
- How does each element fit into the company's overall compensation objectives and affect decisions regarding other elements?

Detailed Discussion of Equity Granting Practices. Expanded disclosure about equity granting practices is required under the new rules. This heightened level of disclosure reflects the significant attention currently being paid to the practices of public companies in the granting of stock options. CD&A must provide enhanced narrative discussion of equity grants to executive officers and directors, including a discussion of whether the company has a program, plan or practice to time option grants in coordination with the release of material non-public information; whether there are any differences in such practices for grants to executive officers and other employees; the role of the compensation committee in making timed grants and whether the committee delegates authority to management in connection with such practices; and the role of executives in such practices. In addition, detailed information about equity grants to NEOs must be included in the Grants of Plan-Based Awards Table.

Identification of NEOs. The method of determining who the NEOs are has changed in two respects from the prior rules. First, any person who served as a principal executive officer or principal financial officer during the past fiscal year is automatically an NEO. Previously, the principal financial officer was not automatically included in the NEO group. Second, the other three most highly compensated persons serving as executive officers at the end of the fiscal year for whom disclosure must be provided will be determined on the basis of total compensation for the last fiscal year as calculated for purposes of the Summary Compensation Table, but excluding changes in the actuarial value of pension and defined benefit plan benefits and above-market or preferential earnings on deferred compensation. Previously, this determination was made solely on the basis of salary and bonus. As before, the NEO group will include up to two additional persons who would have been included as NEOs but for the fact that they were not serving as executive officers at the end of the fiscal year.

Impact on IPO Companies

The new executive compensation rules raise special concerns for IPO companies:

2007 IPO Companies Will Be Pioneers. Companies seeking to go public in the first quarter of 2007 will be the first companies required to comply with the new rules, since most existing public companies will not have to file their executive compensation disclosures until late April 2007. IPO companies are also likely to be

Grants of Plan-Based Awards

Name	Grant Date	Estimated Future Payouts under Non-Equity Incentive Plan Awards			Estimated Future Payouts under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards
		Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)				

Option Exercises and Stock Vested

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)

the first companies required to respond to SEC comments on the new disclosures.

CD&A Can't Be Purely Prospective. The SEC considered, but rejected, the idea that an IPO company's CD&A could exclude information pertaining to the period during which the company was private. The SEC did agree, however, that IPO companies could emphasize their new and continuing plans and policies.

Significant Management Time and Attention Required. The types of disclosures contemplated by CD&A are new in the IPO context. Under the prior rules, an IPO prospectus did not have to include the compensation committee report on executive compensation found in proxy statements. IPO companies will need to devote increased attention to defining and memorializing the objectives and functioning of the company's compensation programs. This will require, in particular, more time of senior management, who previously could simply oversee preparation of the compensation tables. Moreover, because CD&A may need to address ways in which executive compensation practices deviate from practices followed for other employees, senior management will want to give extra care to how CD&A disclosure may be received by the company's employees.

Coordinate with Compensation Committee. Members of the compensation committee should be involved in the CD&A drafting process, since CD&A must describe the objectives and structure of the company's compensation program. Coordinating input from the compensation committee may be particularly challenging for a company that plans to add new directors in connection with its IPO.

Beyond Disclosure

In addition to the disclosure requirements and resulting concerns discussed above, new public companies can also expect to face significant stockholder scrutiny of their compensation practices—which generally comes in two forms, both of which are associated with the annual meeting of stockholders.

First, a public company typically needs stockholder approval to adopt or materially amend an equity compensation plan or certain cash compensation plans. Voting recommendation services, such as Institutional Shareholder Services (ISS), and major institutional stockholders will not vote in favor of plans that contain, or fail to contain, certain provisions. For example, to gain voting support, equity plans generally must prohibit the repricing of outstanding options, limit transferability of equity awards and explicitly require stockholder approval of any material plan amendments. The number of shares covered by an equity plan must also satisfy quantitative guidelines established by these institutions, which result in frequently having to seek stockholder approval of share increases.

Second, executive compensation is a favorite topic of non-binding stockholder proposals submitted for inclusion in a company's annual meeting proxy statement. There are several popular stockholder proposals for the 2007 proxy season:

Pay for Superior Performance – calls for incentive plans and bonuses to be tied to performance criteria that are benchmarked against a disclosed peer group of companies—with no payout unless the company exceeds the median or mean performance of the peer group

Say on Pay – asks that stockholders be given the opportunity at each annual meeting to ratify the compensation paid to the NEOs

Vote on Severance – seeks to require stockholder approval of any agreement that provides severance benefits in excess of a specified multiple of base salary plus target bonus

Clawback Following Restatement – seeks to extend the clawback provisions contained in the Sarbanes-Oxley Act to require recoupment of executive bonuses from a broader group of executives than just the CEO and CFO in the event of a restatement

Reform Option Granting Practices – calls for companies to establish a fixed grant schedule that is publicly announced in advance of each year (this proposal is focused primarily on companies under investigation for alleged backdating of options) ■

Outstanding Equity Awards at Fiscal Year-End

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)

Pension Benefits

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments during Last Fiscal Year ($)

Compensation Issues to Be Addressed by CD&A

Examples of issues the SEC suggests may be appropriate for examination in CD&A include:

- Policies for allocating between long-term and currently paid-out compensation
- Policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation
- For long-term compensation, the basis for allocating compensation to each different form of award
- How the determination is made as to when awards are granted, including awards of equity-based compensation such as options
- What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions
- How specific forms of compensation are structured and implemented to reflect items of the company's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified NEOs or to all compensation subject to the relevant performance goal
- How specific forms of compensation are structured and implemented to reflect the NEO's individual performance or individual contribution to the company's performance, describing the elements of individual performance or contribution that are taken into account
- The company's policies and decisions regarding the adjustment or recovery of awards or payments if the relevant company performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment
- The factors considered in decisions to increase or decrease compensation materially
- How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (for example, how gains from prior option or stock awards are considered in setting retirement benefits)
- With respect to any contract, agreement, plan or arrangement—whether written or unwritten—that provides for payments at, following or in connection with any termination or change-in-control, the basis for selecting particular events as triggering payment
- The impact of accounting and tax treatments of a particular form of compensation
- The company's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any company policies regarding hedging the economic risk of such ownership
- Whether the company engaged in any benchmarking of total compensation or any material element of compensation, identifying the benchmark and, if applicable, its components
- The role executive officers play in the compensation process

Nonqualified Deferred Compensation

Name	Executive Contributions in Last Fiscal Year ($)	Registrant Contributions in Last Fiscal Year ($)	Aggregate Earnings in Last Fiscal Year ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last Fiscal Year-End ($)

Director Compensation

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)

An IPO is a major milestone for any company, but it does not necessarily mean that all future equity capital will be raised through follow-on public offerings. Two popular financing transactions for public companies—PIPEs and Rule 144A placements—involve private placements. Both are likely to remain desirable and accessible alternatives for many issuers in 2007.

PIPEs Financings

The PIPEs (Private Investments in Public Equity) market surged to record levels in 2006, as public companies increasingly tapped it to meet their capital needs. Deal volume, dollar volume and average deal size all jumped from 2005. Pricing (measured in terms of fixed-price discounts and warrant coverage) was largely unchanged.

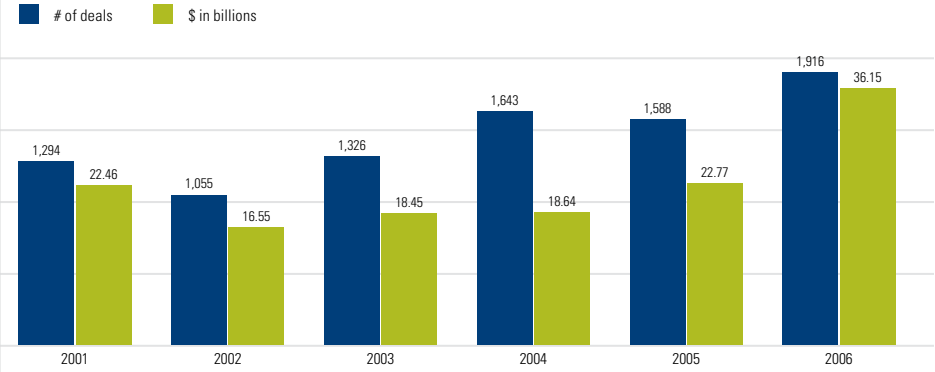
The number of PIPEs deals (including registered direct offerings) increased from 1,588 in 2005 to a record 1,916 in 2006, and dollar volume soared from $22.8 billion to a new high of $36.1 billion. Average deal size reached a record $18.9 million, up from $14.3 million in 2005, topping the previous record of $17.4 million in 2001.

Consistent with recent years, companies with market capitalizations under $250 million were responsible for 90% of all PIPEs financings in 2006. Companies with market caps of less than $100 million accounted for 72% of all PIPEs deals in 2006, while companies with market caps below $50 million accounted for 53% of all PIPEs.

Biotechnology and pharmaceutical companies led the PIPEs market again in 2006, generating 15% of all deals with an average deal size of $19.2 million, compared to 14% of all deals in 2005 with an average deal size of $15.8 million. Four other sectors each accounted for at least 5% of the PIPEs market in 2006: energy (13% of market with $38.7 million average deal size); metals, minerals and stones (11% and $11.9 million); mining (8% and $8.3 million); and medical devices (6% and $25.4 million).

Overall, technology companies produced 39% of all PIPEs financings in 2006, down from 42% in 2005.

PIPEs Financings – 2001 to 2006



Source: PrivateRaise

Largest PIPEs Financings by Eastern US Life Sciences Companies – 2001 to 2006

Issuer	Proceeds	Issuer Counsel
2006		
Keryx Biopharmaceuticals, Inc.	$82,800,000	Alston & Bird LLP
Momenta Pharmaceuticals, Inc.	$75,000,000	Wilmer Cutler Pickering Hale and Dorr LLP
NitroMed, Inc.	$62,505,000	Wilmer Cutler Pickering Hale and Dorr LLP
2005		
Alnylam Pharmaceuticals, Inc.	$58,526,000	Wilmer Cutler Pickering Hale and Dorr LLP
Critical Therapeutics, Inc.	$54,500,000	Wilmer Cutler Pickering Hale and Dorr LLP
DrugMax, Inc.	$45,221,000	Sichenzia Ross Friedman Ference LLP
2004		
Neurogen Corporation	$100,000,000	Milbank, Tweed, Hadley & McCloy LLP
Genome Therapeutics Corp.	$88,200,000	Ropes & Gray LLP
Idenix Pharmaceuticals, Inc.	$75,600,000	Wilmer Cutler Pickering Hale and Dorr LLP
2003		
Penwest Pharmaceuticals Co.	$52,663,000	Wilmer Cutler Pickering Hale and Dorr LLP
Advanced Viral Research Corp.	$50,000,000	Kirkpatrick & Lockhart Nicholson Graham LLP
Regeneron Pharmaceuticals, Inc.	$48,000,000	Skadden, Arps, Slate, Meagher & Flom LLP
2002		
Genta Incorporated	$71,921,000	Wilson Sonsini Goodrich & Rosati
Triangle Pharmaceuticals, Inc.	$50,000,000	Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, LLP
Trimeris, Inc.	$42,755,000	Wilmer Cutler Pickering Hale and Dorr LLP
2001		
CuraGen Corporation	$85,000,000	Mintz Levin Cohn Ferris Glovsky and Popeo P.C.
Triangle Pharmaceuticals, Inc.	$75,000,000	Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, L.L.P.
Biopure Corporation	$75,000,000	LeBoeuf, Lamb, Greene & MacRae LLP

Based on companies located east of the Mississippi River and listed in the following PrivateRaise sectors: biotech and pharmaceuticals.

Source: PrivateRaise and SEC filings

Of all PIPEs financings in 2006, 59% were common stock (average deal size of $19.9 million), 23% were convertible debt ($7.6 million average), 8% were convertible preferred stock ($23.0 million average), 4% were equity lines ($25.6 million average), 4% were non-convertible debt ($8.6 million average) and 2% were other instruments. This breakdown reflects a modest shift back to common stock deals from convertible deals, which had been on an upswing since 2003 as investors sought more protection in uncertain capital markets.

Fixed-price deals continued to dominate the PIPEs market in 2006, representing 85% of all deals, but were down from 87% in 2005. The percentage of deals with variable pricing increased again, from 10% in 2005 to 12% in 2006, compared to only 5% as recently as 2003. The average discount from market in fixed-price common stock deals slipped to 8.1% in 2006 from 8.5% the prior year (compared to a hefty 14% in 2004).

Warrant terms were slightly less favorable for PIPEs issuers in 2006 than in 2005. The percentage of deals that included warrants inched up from 55% to 56%, and the average exercise premium dipped from 23% to 20%. The average warrant coverage (aggregate warrant exercise price as a percentage of deal size) climbed from 65% in 2005 to 67% in 2006.

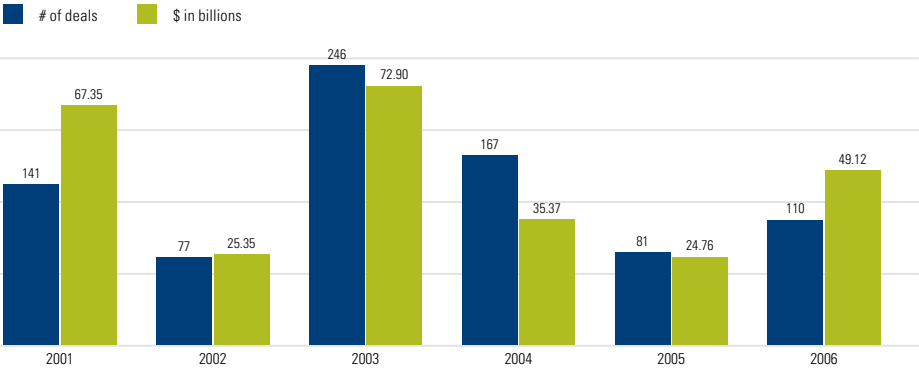
Now firmly ensconced in the financing mainstream, particularly for small-cap and mid-cap issuers, the PIPEs market should continue to play an important corporate finance role in 2007.

Rule 144A Placements

The Rule 144A market for equity securities (including convertible debt) rebounded smartly in 2006. The number of placements was up more than one-third from 2005, and gross proceeds doubled to reach their highest level since 2003's record. The strong results occurred despite the SEC's new well-known seasoned issuer (WKSI) rules, which no doubt siphoned many convertible debt deals out of the Rule 144A market in favor of registered public offerings.

The number of Rule 144A equity placements increased 36%, from 81 in 2005 to 110 in 2006, and gross proceeds doubled from $24.8 billion to $49.1 billion.

Rule 144A Equity Placements – 2001 to 2006



Includes placements of convertible notes and debentures.

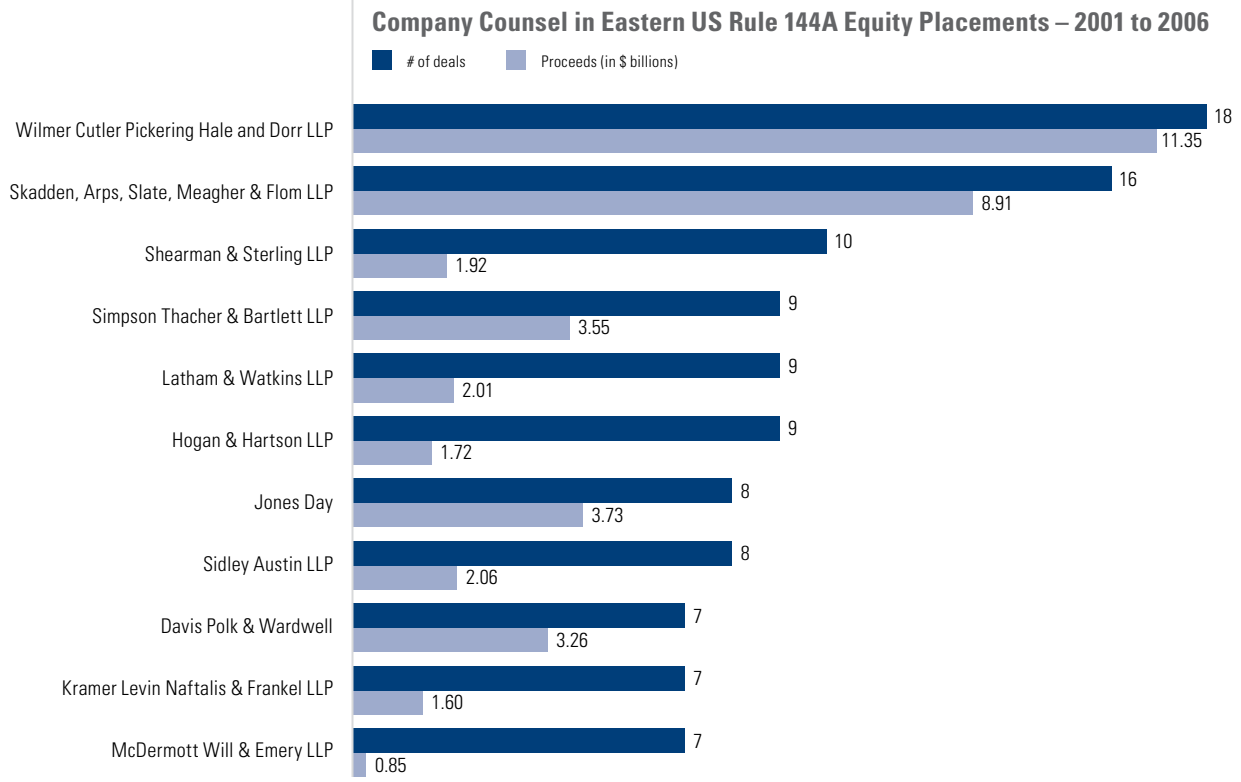
Source: PrivateRaise

Largest Rule 144A Equity Placements by Eastern Technology Companies – 2001 to 2006

Issuer	Proceeds	Issuer Counsel
2006		
Medtronic, Inc.	$4,400,000,000	Wilmer Cutler Pickering Hale and Dorr LLP
EMC Corporation	$3,450,000,000	Skadden, Arps, Slate, Meagher & Flom LLP
MedImmune, Inc.	$1,150,000,000	Dewey Ballantine LLP
2005		
L-3 Communications Holdings, Inc.	$700,000,000	Simpson Thacher & Bartlett LLP
IVAX Corporation	$350,000,000	Stearns Weaver Miller Weissler Alhadeff & Sitterson, P.A.
NII Holdings Inc.	$350,000,000	Williams Mullen
2004		
Red Hat, Inc.	$600,000,000	Wilmer Cutler Pickering Hale and Dorr LLP
ImClone Systems Incorporated	$600,000,000	Davis Polk & Wardwell
Sepracor Inc.	$500,000,000	Wilmer Cutler Pickering Hale and Dorr LLP
2003		
Bristol-Myers Squibb Company	$1,200,000,000	Cravath, Swaine & Moore LLP
Wyeth	$1,020,000,000	Simpson Thacher & Bartlett LLP
Sepracor Inc.	$750,000,000	Wilmer Cutler Pickering Hale and Dorr LLP
2002		
Lucent Technologies Inc.	$1,750,000,000	Cravath, Swaine & Moore LLP
Computer Associates International, Inc.	$660,000,000	Covington & Burling LLP
Computer Associates International, Inc.	$460,000,000	Covington & Burling LLP
2001		
Verizon Communications Inc.	$3,000,000,000	In-house counsel
Medtronic, Inc.	$2,012,500,000	Sullivan & Cromwell LLP
Lucent Technologies Inc.	$1,885,000,000	Cravath, Swaine & Moore LLP

Based on companies located east of the Mississippi River and listed in the following PrivateRaise sectors: aerospace & defense, biotech, computers, medical devices, Internet, pharmaceuticals, semiconductors, software and telco.

Source: PrivateRaise and SEC filings



The above chart is based on companies located east of the Mississippi River.
Source: PrivateRaise

Average deal size increased to $446.5 million in 2006 from $305.7 million the year before. The increase in gross proceeds and average deal size was driven by a quadrupling of billion-dollar placements from four in 2005 to 16 in 2006, 11 of which were by technology companies.

Rule 144A issuers tend to be much larger and more mature than issuers in the PIPEs market. Only 5% of Rule 144A equity placements in 2006 were completed by companies with market capitalizations under $250 million, compared to 90% of PIPEs financings.

Biotechnology and pharmaceutical companies, which accounted for 15% of all deals in 2006, were edged out by REITs (16% of deals) and lost top billing in the Rule 144A equity market for the first time since 2001. However, average deal size for placements by biotechnology and pharmaceutical companies soared from $185.3 million in 2005 to $628.9 million in 2006, doubling the REIT average of $324.0 million. The third largest sector in 2006 was electronics, with 7% of all deals and an average deal size of $166.5 million, followed by energy (6% and $630.3 million) and medical devices (5% and $971.7 million). No other sector accounted for more than 5% of the market.

Overall, technology companies completed 38% of all Rule 144A equity placements in 2006, down from 40% in 2005.

In 2006, 96% of all Rule 144A equity placements involved the issuance of convertible debt securities, up from 90% in 2005. Convertible preferred stock deals almost disappeared during the year, dropping to 3% of the market after increasing for three consecutive years to reach 9% in 2005. SEC rules do not permit public companies to offer common stock in Rule 144A placements.

Seasoned companies have long recognized the faster execution time and greater flexibility afforded by Rule 144A placements. WKSIs can now enjoy these same advantages with registered public offerings while avoiding the expense and effort of resale registration following a Rule 144A placement. As a result, we expect that convertible debt offerings by large-cap issuers increasingly will be structured as registered public offerings, but the Rule 144A market should remain an important source of capital for many other companies. ■

Since late 2005, any well-known seasoned issuer (WKSI)—a company that is S-3 or F-3 eligible and either has a public float of at least $700 million or has issued at least $1 billion of debt securities in registered transactions in the past three years—has been able to file automatically effective shelf registration statements. As a result, WKSIs can make registered public offerings at will and reap the time-to-market advantage previously afforded only by Rule 144A placements. Because the Rule 144A market has historically been dominated by large-cap companies (companies with market capitalizations in excess of $1 billion accounted for a majority of all Rule 144A equity placements between 2001 and 2005), the new WKSI rules have prompted many eligible issuers to make registered public offerings of convertible debt deals that previously would have been placed in the Rule 144A market.

As we approach the fifth anniversary of the Sarbanes-Oxley Act, most of its provisions have become, more or less, accepted parts of the regulatory landscape. Not so for Section 404, which governs internal control over financial reporting (ICFR). Controversy continues unabated over the burdens of the ICFR process and whether its benefits outweigh the costs. In response to this issue, and perhaps only a few steps ahead of legislative action, both the SEC and the Public Company Accounting Oversight Board (PCAOB) are attempting to redesign the regulatory structures that have risen around Section 404.

As implemented by SEC and PCAOB rules, Section 404 of the Sarbanes-Oxley Act establishes a two-part process for judging the effectiveness of a company's ICFR. Part One requires a company's management to annually assess the effectiveness of ICFR and to include a report on ICFR in its Form 10-K annual report. The SEC's rules govern management's evaluation. Part Two requires the company's independent accountants to audit and report on management's assessment and, separately, on the effectiveness of the company's ICFR. The PCAOB's Auditing Standard 2 (AS-2) prescribes how accountants must perform the audit.

From the outset, there have been complaints that the Section 404 process has resulted in excessive costs to companies, which have not been offset by concrete benefits in terms of more reliable financial statements. In particular, the costs have been said to affect smaller companies disproportionately. More recently, there has been considerable angst that Section 404, along with other aspects of US securities regulation, has adversely affected the competitive position of the US capital markets.

The SEC has taken several actions in response to concerns about Section 404, particularly insofar as it affects small or newly public companies:

- Again extending the compliance date for "non-accelerated filers" to file management assessments—for most of these companies the first 404 assessments will now be required as of the end of their 2007 fiscal year, followed by their 10-Ks in 2008
- Excusing non-accelerated filers from providing an auditor attestation on ICFR until one year after they file their first management assessment—for most small companies this will be for the 2008 fiscal year
- Allowing newly public companies until their **second** 10-K after they become public (by IPO or otherwise) to file a management assessment and auditor attestation

More generally, the SEC has acknowledged that its current rules do not provide sufficient guidance to management on how to conduct its assessment. In December 2006, the SEC proposed new guidance and rules for ICFR evaluations. The SEC's proposals reflect a "principles-based" approach that allows companies to tailor their ICFR assessments to their individual circumstances. Among the key elements of the SEC's proposals are:

- Along with the PCAOB, reformulating the standard for a "material weakness" in ICFR to require a "reasonable possibility" that a material misstatement will not be detected or prevented, rather than the looser "more than remote possibility" standard
- Defining a "risk-based" assessment process that (1) evaluates the design of controls to determine whether they adequately address the risk that material misstatements would not be prevented or detected, and (2) evaluates evidence about operations of those controls
- Explaining how companies can satisfy the SEC's requirements to document their ICFR assessment based on the company's particular situation and risk levels associated with particular processes
- Reaffirming that "material weaknesses" (as redefined) must be disclosed, and that management cannot conclude that controls are effective if a material weakness exists
- Eliminating the requirement that accountants audit management's assessment of ICFR effectiveness separately from their audit of ICFR itself

What the SEC has **not** done, however, is exempt small companies from 404 altogether, as some advocated. Nor does the SEC propose special rules for smaller companies. According to the SEC, its proposed guidance is intended to be highly "scalable" to these companies. For instance, it gives the management of small companies flexibility to use its daily interaction with internal controls as a component of its assessment and, accordingly, to limit the need for extensive testing.

Along the same lines, the PCAOB has proposed to replace AS-2 with a shorter, more user-friendly auditing standard. New Auditing Standard 5 focuses auditors on evaluating the most important internal controls that may identify the problems that are most likely to result in a material misstatement of a company's financial statements, and eliminates certain audit requirements that result in unnecessary work and cost. Among the key features of the PCAOB's proposals:

- Redefining "material weakness" and "significant deficiency," thereby shrinking the potential universe of reportable matters and, presumably, the amount of testing necessary to assess the effectiveness of ICFR
- Consistent with the SEC proposals, eliminating the separate auditor attestation of management's assessment
- Permitting auditors to consider knowledge obtained during previous audits and to evaluate company-level controls as a substitute for costly testing of process- or transaction-level controls
- Encouraging auditors to make ICFR audits scalable to small companies
- In a separate rule, providing new guidance on when auditors may appropriately rely on the work of others in ICFR and financial statement audits

Both sets of proposals are subject to public comment and final agency action. It remains to be seen whether these proposals will lead to meaningful reforms in the process that will benefit companies by reducing costs and burdens while providing reasonable assurances to investors about the effectiveness of the controls underlying financial statements. ■

AIM (the junior market of the London Stock Exchange) enjoyed another strong year in 2006 and is continuing to emerge as the listing platform of choice for smaller growth companies, including US companies that have been deterred from an IPO on Nasdaq due to increased costs and complexities of going public in the United States.

In 2006, 462 companies joined AIM, raising a total of £9.9 billion. The number of trades increased 36% from 2005, reaching 3.5 million transactions in 2006. When combined with a 22% increase in the number of shares traded and higher price levels, the total transaction value on AIM increased from £42.2 billion in 2005 to £58 billion in 2006.

International Attraction

AIM is also becoming increasingly international. Of the 1,634 companies listed on AIM at the end of 2006, 306 were non-UK companies (including 36 from the United States). Of the 462 companies admitted to AIM during 2006, 124 (27% of the total) were incorporated outside of the United Kingdom (14 of which were US corporations).

Although AIM is proving to be attractive to international companies, an IPO on AIM by an English or other European company may, from a commercial perspective, be of more interest to European investors than an IPO of a foreign company. As a result, in preparing for an AIM flotation, it is now common for overseas companies to consider reincorporating, often through the creation of a new English holding company.

US companies considering a pre-float restructuring must consider the following legal and commercial issues:

Location of Investors

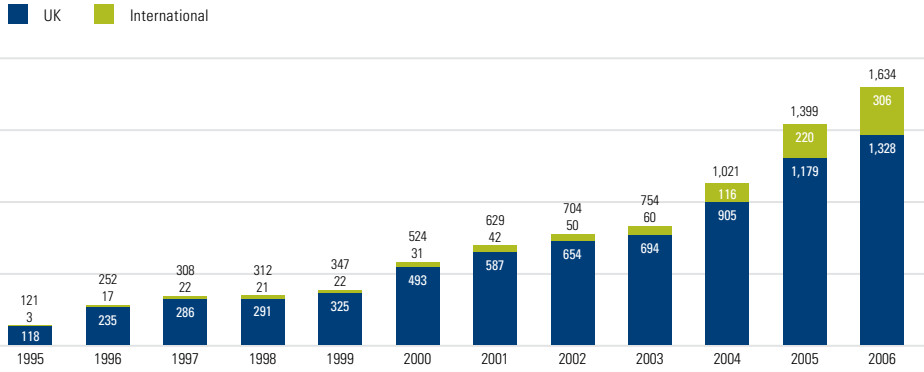
Some AIM investors may prefer to purchase shares in English companies rather than US companies due to a perception of reduced liquidity for US stocks, as discussed below. In addition, some investment funds have rules that prevent them from investing in non-English (or other non-European) companies.

Accordingly, an overseas company contemplating a new holding company structure should, at an early stage and in consultation with its AIM sponsor/broker, consider the likely jurisdiction of potential investors and their views on holding stock in a foreign company.

Liquidity

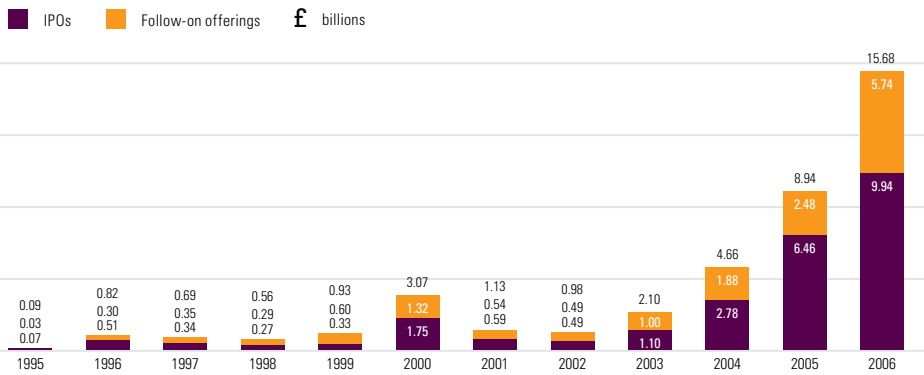
Stock trades on AIM are typically made through the CREST electronic settlement system (similar to the Depository Trust Company in the United States). If the AIM listing of a US company is completed without SEC registration, US securities laws can create resale liquidity issues because Regulation S—which exempts non-US offerings from SEC registration—requires the shares to bear a legend restricting transfers to US persons for a period of one year after issuance. As a result, trades in shares of US companies cannot currently be settled via CREST while the transfer restrictions exist, negatively impacting trading liquidity.

Number of Listed Companies at Year-End – 1995 to 2006



Source: AIM Market Statistics, December 2006; London Stock Exchange

Gross Proceeds – 1995 to 2006



Source: AIM Market Statistics, December 2006; London Stock Exchange

In 2006, however, a new electronic settlement service was introduced to permit participating brokers to settle trades on AIM in shares of US companies that are subject to Regulation S, even if the securities are uncertificated. Through the use of electronic "tags" that identify the nationality of purchasers, sales to US persons can be rejected while other sales are completed. Although this new settlement service facilitates compliance with the non-US purchaser provisions of Regulation S, it does not affect compliance with the other requirements of Regulation S, which remain the responsibility of the issuer.

Increasing familiarity with Regulation S requirements among UK and other European investors, coupled with the new electronic settlement service described above, have reduced but not eliminated the perception that stocks of US companies are less liquid on AIM.

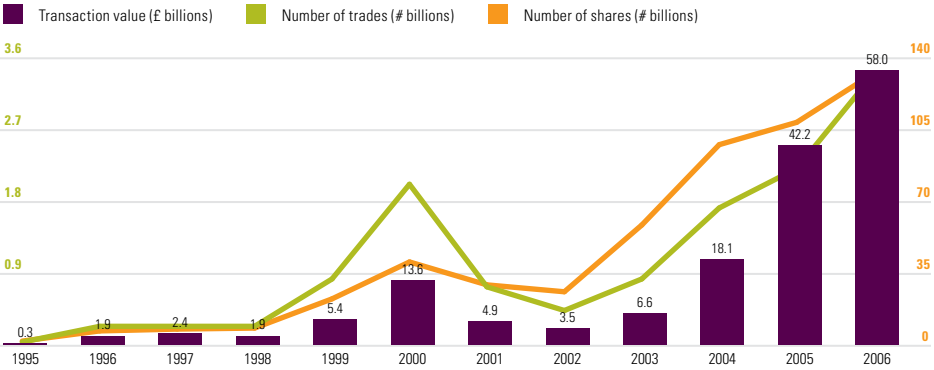
The Regulation S resale restrictions do not apply if a US company puts an English (or other European) holding company in place prior to its AIM listing, because the issuer of the shares in the IPO would no longer be a US company.

US Securities Laws

It should be noted that if a primary reason for floating a US company on AIM is to avoid the US securities laws, that goal may be achievable only for a limited amount of time.

Under US securities laws, a US company must register with the SEC within 120 days after the end of its first fiscal year in which it has 500 or more stockholders of record of the same class of security and at least $10 million in total assets. Once registered, a US company is subject to the same requirements—including the provisions of the Sarbanes-Oxley Act—as a company that is listed on a US exchange. Once listed on AIM, a US company will be unable to control the number of people holding its shares. Therefore, while an AIM listing may serve as a less expensive IPO alternative for a US company, the expense and burden of operating as a US reporting company may not be able to be avoided for long.

Trading Volume – 1995 to 2006



Source: AIM Market Statistics, December 2006; London Stock Exchange

Again, these requirements do not apply if a US company reincorporates in England or another European country prior to its AIM listing.

Other Legal Consequences

If a US company reincorporates in England, it will become subject to the corporate laws applying to English companies. Directors would need to become familiar with the relevant UK rules and regulations, including:

- The requirement that new issuances of shares for cash be made pro rata to existing stockholders on a preemptive basis before offering them to third parties, unless prior stockholder approval is obtained (in contrast, a US company can ordinarily eliminate such preemptive rights in its corporate charter)
- The limited circumstances in which an English company, unlike a US company, can repurchase its own shares
- The general unavailability of the anti-takeover measures that are commonplace in the United States
- The absence of the concept of a merger under English law, forcing acquisitions to be generally structured as asset purchases or individual stock purchases, which could dissuade US companies from pursuing the acquisition of an English company

Restructuring Considerations

Implementing a new holding company structure can be expensive. The required legal, tax and accounting costs and management time should be carefully considered together with the potential benefits, including the likelihood that ongoing compliance costs will be lower in the United Kingdom than in the United States.

A restructuring will involve some form of change of control, as a new holding company would need to be put in place. A US company will therefore need to consider the composition of its stockholder base and the tax consequences—for itself and its stockholders—of the restructuring.

A US company should also consider the impact that any restructuring will have on customer contracts and employee stock plans. Due to stock repurchase restrictions, restricted stock plans traditionally used by US companies may not be workable in an English company.

Conclusion

An AIM listing for a US company can be an attractive alternative to an IPO on Nasdaq or another US exchange. However, an AIM flotation—and the corporate restructuring that may precede it for a US company—requires careful analysis of the relevant considerations, including the different legal and tax regimes that will apply following reincorporation. ■

Scrutiny of public companies has never been greater, nor the specter of personal liability for directors and officers so palpable. In recent years, Congress has enacted the Sarbanes-Oxley Act and other new legislation, and the SEC and stock exchanges have adopted numerous new rules. And if that were not enough for a public company to juggle and manage, institutional investors and corporate watchdogs are increasingly beating the drum of corporate governance "best practices."

While lacking the force of law, best practices cannot be ignored. Shareholder organizations, such as Institutional Shareholder Services (ISS), routinely measure public companies against lengthy lists of desirable practices. Major institutional investors, such as CalPERS and Fidelity, have their own governance yardsticks, which often differ from ISS. The results of these governance assessments can influence recommendations or shareholder voting.

The litany of topics swept in by the catchall phrase "best practices" ranges from some that are concrete and prudent to others that are aspirational or unrealistic. Nonetheless, directors who turn a deaf ear to shareholder demands for better governance may find votes withheld in board elections, be required to include shareholder proposals in their proxy statements or even find their actions questioned in litigation. In some cases, ignoring best practices could also result in a lost opportunity to truly improve the company's operations and oversight.

Listed below are some of the practices and policies that public companies may be urged to follow. Needless to say, circumstances vary widely, and these may or may not be appropriate for a particular company.

Board of Directors

- Ensure that all board members, other than the CEO, are independent
- Separate the roles of chair and CEO, or designate a lead director if the chair and CEO are the same person
- Regularly convene executive sessions of the independent directors only (required by Nasdaq and NYSE rules)
- Arrange for orientation training and continuing education for all directors
- Conduct annual reviews of board and committee performance (required by NYSE rules) and individual director performance
- Develop a CEO succession plan
- Establish director term and age limits
- Limit the number of other directorships the CEO and other directors may hold
- Select director nominees in accordance with the board's published director qualification standards
- Increase board diversity
- Require directors to offer to tender their resignations upon job changes
- Create stock ownership guidelines or requirements for officers and directors

Board Committees

- Ensure that a majority of, or all, members of the Audit Committee qualify as "Audit Committee Financial Experts" under SEC rules
- Establish a Compensation Committee consisting solely of independent directors (required by NYSE rules)
- Establish a separate Nominating/Governance Committee consisting solely of independent directors (required by NYSE rules)
- Adopt a written charter for each board committee (required by NYSE rules)

Stockholder Relations

- Elect all directors annually, instead of having a classified board
- Provide that directors are elected by majority vote, rather than a plurality
- If board vacancies are filled by board action, permit shareholders to vote on new directors at the next annual meeting
- Establish a process that provides shareholders a meaningful opportunity to suggest candidates for director nominations or otherwise communicate with the board
- Obtain shareholder approval of all option plans (required by Nasdaq and NYSE rules)
- Do not adopt a poison pill without shareholder approval
- Provide that a simple majority vote of shareholders may amend the corporate charter or bylaws
- Permit shareholders to act by written consent
- Allow shareholders holding more than a specified percentage of shares to call special meetings
- Do not authorize a dual-class capital structure, or blank check preferred stock

Other Governance Matters

- Establish Corporate Governance Guidelines (required by NYSE rules)
- Adopt a Code of Conduct for all directors and employees (required by Nasdaq and NYSE rules)
- Adopt a Related Person Transaction Policy
- Adopt an Insider Trading Policy
- Adopt a Disclosure Policy
- Establish a Disclosure Committee
- Post corporate governance documents on corporate website (required by NYSE rules)
- Post SEC filings on corporate website ■

Want to know more about the latest in the venture capital and M&A markets?

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Our *2006 M&A Report* offers a detailed review of the global M&A market and discusses the outlook for 2007. Other highlights include a survey of key terms and issues in sales of VC-backed companies, insight into the use of tender offers for friendly acquisitions, a look at changes in shareholder rights plans, and practical guidance on avoiding post-closing challenges by antitrust agencies.

For summaries and analysis of compensation data collected from hundreds of executives and private companies located throughout the country, see the *2006 Compensation and Entrepreneurship Report in Information Technology* and the *2006 Compensation and Entrepreneurship Report in Life Sciences* at www.wilmerhale.com/compreports.

To request a copy of any of the reports described above, or to obtain additional copies of the *2006 IPO Report*, please contact the WilmerHale Marketing and Business Development Department at marketing@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at www.wilmerhale.com/2006IPOreport.

Data Sources

WilmerHale compiled all data in this report unless otherwise noted. Offerings by REITs, bank conversions and closed-end investment trusts are excluded. Offering proceeds exclude proceeds from exercise of underwriters' over-allotment options, if applicable. For lead underwriter rankings, IPOs are included under the current name of each investment bank. For law firm rankings, IPOs are included under the current name of each law firm. Venture capital data is sourced from Dow Jones VentureOne. PIPEs data is sourced from PrivateRaise and The PIPEs Report. Rule 144A data is sourced from PrivateRaise.

Prior results do not guarantee a similar outcome.

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