2012 IPO Report

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REVIEW

The US IPO market produced 110 IPOs in 2011—a 23% decline from the 142 IPOs in 2010. Through the first seven months of 2011, the number of offerings was well above the number in the comparable period of the prior year, but then the IPO market stalled due to European economic concerns. After producing a mere four IPOs from August to October, the market rebounded nicely to end the year with strong momentum, which has carried over into 2012.

Gross proceeds dropped 14%, to $31.1 billion in 2011 from $36.3 billion in 2010. The percentage decline in gross proceeds was less significant than the reduction in deal flow, due to the presence of six billion-dollar offerings in 2011. The sole offering of this magnitude in 2010 was the $20.1 billion offering by General Motors—the largest IPO in US history—without which gross proceeds in 2010 would have lagged behind the 2011 total by a wide margin.

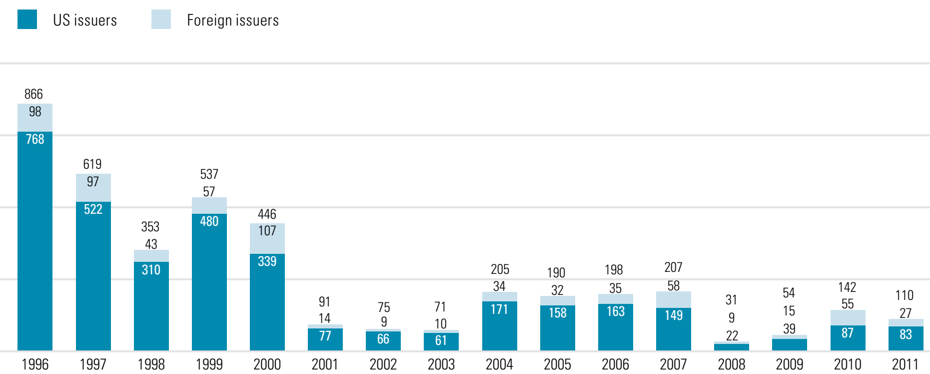
The largest IPO of 2011 came from hospital operator HCA Holdings ($3.79 billion). Yandex, Russia's leading online search engine, produced the year's largest tech IPO ($1.435 billion).

Median IPO size increased almost 50%, from $100.0 million in 2010 to $147.8 million in 2011. The 2011 figure represented a resumption of the upward trend in median deal size since 2004.

In 2011, there were two "moonshots" (IPOs that double in price on their opening day)—Chinese Internet company Qihoo 360 Technology soared 134% in first-day trading, and online professional network company LinkedIn jumped 109%. Qihoo surrendered most of this gain in the aftermarket, ending the year up only 8%, while LinkedIn also retrenched, to end 2011 up 40%.

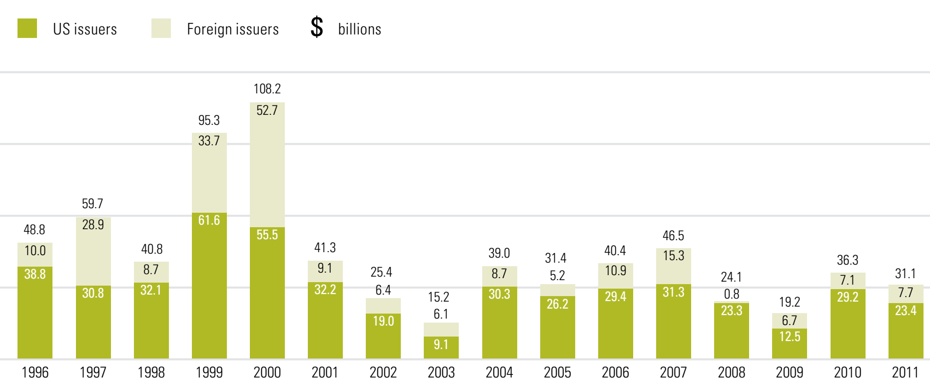
The average first-day gain for all IPOs in 2011 was 12%, and 27% of the year's offerings were "broken" IPOs (IPOs whose stock closes below the offering price on their opening day). These results compare favorably to 2010, when the average first-day gain for all IPOs was 10%, and 32% of the year's offerings were broken IPOs.

US IPOs – 1996 to 2011



Source: SEC filings

US IPO Dollar Volume – 1996 to 2011



Source: SEC filings

Aftermarket performance, however, was much poorer in 2011 than in 2010, as capital markets were buffeted in the third quarter of the year. The average 2011 IPO lost 11% from its offering price by the end of the year, with only 46% of the year's IPOs trading at or above their offering price at year-end. By contrast, the average 2010 IPO appreciated 28% by the end of the year, and 68% of the year's IPOs were trading at or above their offering price at year-end. Performance metrics from first-day close to year-end painted an even starker picture, with the average IPO of 2011 declining 20% on this measure.

IPO companies were less profitable in 2011 than in recent years. The percentage of profitable companies going public dropped from 59% in 2010 to 55% in 2011—the lowest percentage since the tail of the dot-com boom in 2001. The median annual revenue of IPO companies increased slightly, from $100.8 million in 2010 to $105.2 million in 2011. These results illustrate the continuing bifurcation of the IPO market, which seeks larger and more profitable companies, while also embracing emerging technology companies with strong growth and a demonstrated path toward profitability.

Individual components of the IPO market fared as follows in 2011:

- With 42 offerings, venture capital–backed IPOs represented 38% of the market in 2011, compared to 43 deals and a 30% market share in 2010. Most of these venture capital–backed IPOs were by technology or life sciences companies. The average 2011 VC–backed IPO lost 6% from its offering price through year-end.
- Private equity–backed IPOs grabbed 26% of the market in 2011, with 29 offerings, compared to 39 offerings for a 27% market share in 2010. The three largest IPOs of 2011 were the largest private equity–backed offerings in US history: HCA Holdings ($3.79 billion), Kinder Morgan ($2.86 billion) and Nielsen Holdings ($1.64 billion).
- Deal flow in the technology sector remained strong in 2011. Tech-related companies produced 54% of the year's IPOs, up slightly from 53% in 2010. Tech IPOs, however, fared worse in the aftermarket than IPOs in other sectors, with an average loss through year-end of 16%—pulled down by a number of very poorly performing Chinese tech IPOs—compared to the average loss of 5% for non-tech IPOs.
- Foreign issuers accounted for 25% of the market in 2011, down from 39% in 2010 and the lowest level since 2006. China, which produced a lofty 40 IPOs in 2010, sent only 13 IPOs to the US in 2011.

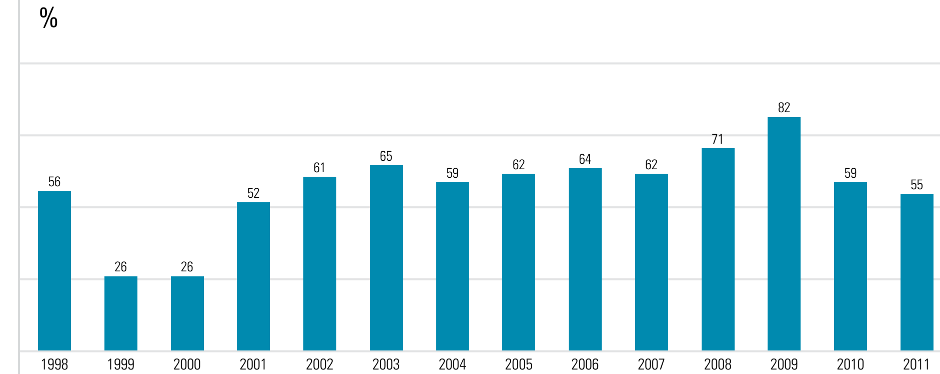
In 2011, companies based in the western United States (west of the Mississippi River) completed 55 IPOs—a figure buoyed by 15 IPOs from Texas and five from Oklahoma, 80% of which were energy-related. Eastern US–based issuers accounted for 28 IPOs, and foreign issuers accounted for the remaining 27 IPOs.

OUTLOOK

Although we remain fundamentally optimistic about the long-term prospects for the IPO market, economic uncertainty lies close to the surface. IPO market activity in the coming year will depend on a number of factors, including the following:

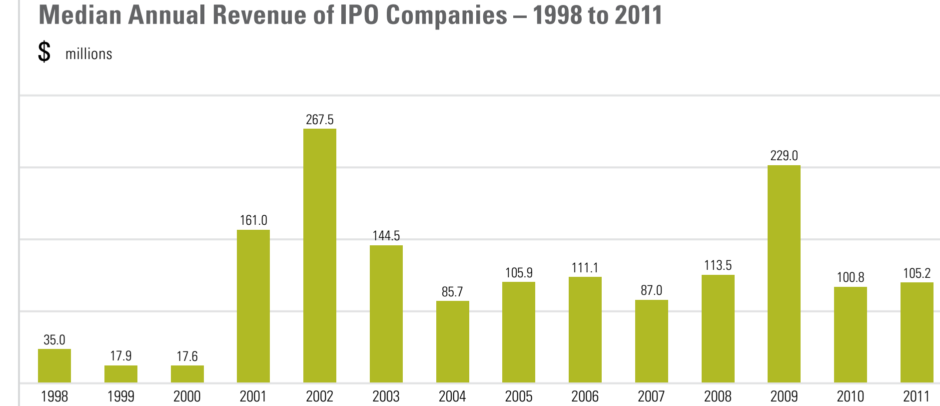
- *Economic Conditions:* Economic growth is a key determinant of strength in the capital markets. After a recession that was longer and more severe than almost anyone anticipated, the economy began to recover by mid-2009. Since then, economic recovery has been accompanied by mixed signals, and the timing and extent of economic growth remains uncertain.
- *Capital Market Conditions:* Stable and robust capital markets are a leading indicator of IPO activity. After two strong years, which saw the Nasdaq surge 44% in 2009 and tack on another 17% in 2010 and the Dow increase 19% in 2009 and 11% in 2010, both indices gyrated in 2011. Recovering from a 15% sell-off in late July and early August, the Dow ended 2011 with a 6% gain for the year. The Nasdaq suffered a steeper mid-summer fall and was not able to recover as quickly as the Dow, ending the year with a 2% loss. In the first quarter of 2012, the Nasdaq jumped 19% and the Dow increased 8%.
- *Geopolitical Factors:* Several geopolitical factors could adversely affect the IPO market. Debt default by troubled Euro-member nations—although staved off, to date, by bailouts and austerity measures—could reverberate globally; the specter of higher oil prices could weigh

Percentage of Profitable IPO Companies – 1998 to 2011



Source: IPO Vital Signs

Median Annual Revenue of IPO Companies – 1998 to 2011



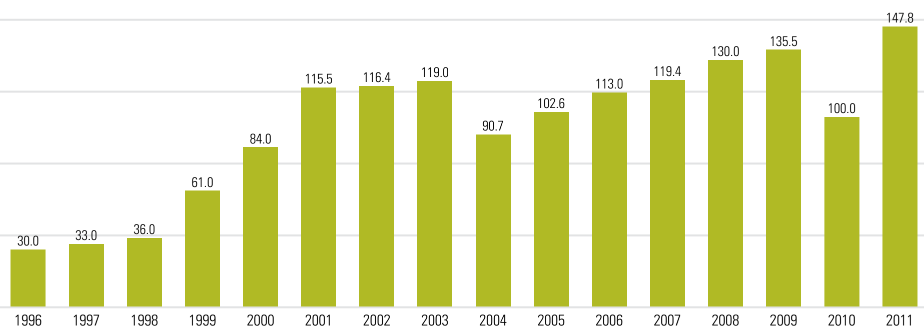
Source: IPO Vital Signs

heavily on the world economy; and there is growing nervousness that the Chinese economy is a bubble waiting to burst.

- *Regulatory Environment:* The corporate governance reforms resulting from the adoption of the Sarbanes-Oxley Act in 2002 and the Dodd-Frank Act in 2010 have helped improve accountability to stockholders, board oversight of management, board member qualifications and investor confidence, but have also increased the compliance cost and potential liability of being public. The new and enhanced governance requirements do not pose a major impediment to going public for most companies, and many of these requirements—such as robust controls—are needed in a growing enterprise, whether or not it ever pursues an IPO. For those IPO candidates that have been deterred from going public by the more rigorous corporate governance environment, however, the new JOBS Act should offer some relief.
- *Impact of JOBS Act:* Enacted in early April 2012, the JOBS Act is intended to improve access to the public capital markets for startup companies. The JOBS Act provides "emerging growth companies" (EGCs) up to five years following their IPO to come into full compliance with certain disclosure and accounting requirements. An EGC is any company that had annual revenues of less than $1 billion (indexed for inflation) during its most recently completed fiscal year, other than a company that completed its IPO on or before December 8, 2011. Approximately 90% of all IPO companies over the past five years would have qualified as EGCs. The extent to which the JOBS Act prompts EGCs that otherwise would have stayed private to go public remains to be seen.
- *Venture Capital Pipeline:* Venture capitalists depend on IPOs—along with company sales—to provide liquidity to their investors. Encouraged by the receptivity of the IPO market to venture capital–backed companies, the number of VC-backed companies entering IPO registration, or resuscitating dormant filings, continues to increase. Longer term, the pool of IPO candidates will be affected by trends in venture capital investing, including the timeline from initial funding to IPO. According to Dow Jones VentureOne, the median time from initial equity financing to IPO fell to 6.5 years in 2011 from 8.1 years in 2010, reflecting an influx of younger and smaller VC-backed companies into the IPO market in 2011.
- *Private Equity Impact:* Private equity investors also seek to divest portfolio companies or achieve liquidity through IPOs. PE-backed companies are usually larger and more seasoned than VC-backed companies or other startups pursuing IPOs, and thus can be strong candidates in a demanding IPO market. Private equity–backed IPOs flourished in 2011 and can be expected to continue to enter the IPO market as conditions permit.

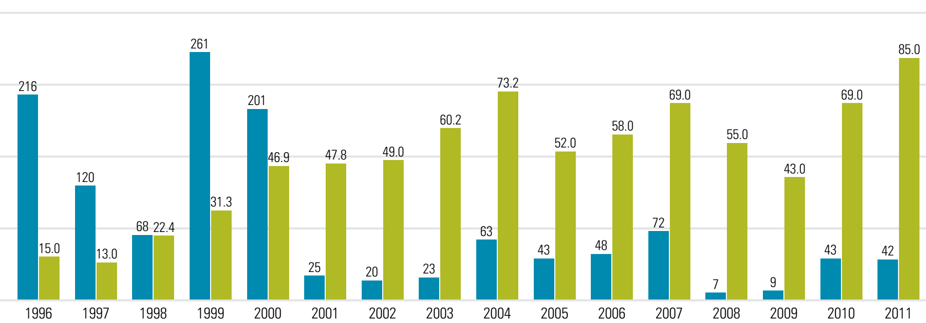
Market momentum has continued into 2012, with the first quarter producing the largest number of first-quarter IPOs since 2007. Year-to-date, the obvious highlight is Facebook's $16.0 billion IPO—the largest tech IPO in history. Other prominent IPOs in early 2012 included Splunk ($229.5 million), Tumi Holdings ($338.0 million) and Yelp ($107.3 million). ■

Median IPO Offering Size – 1996 to 2011



Source: SEC filings

Venture Capital–Backed IPOs – 1996 to 2011



Source: Dow Jones VentureOne and SEC filings
The above chart is based on US IPOs by VC-backed US issuers.

PROFILE OF SUCCESSFUL IPO CANDIDATES

What does it really take to go public? There is no single profile of a successful IPO company, but in general the most attractive candidates have the following attributes:

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

How Do You Compare? Some Facts About the IPO Market

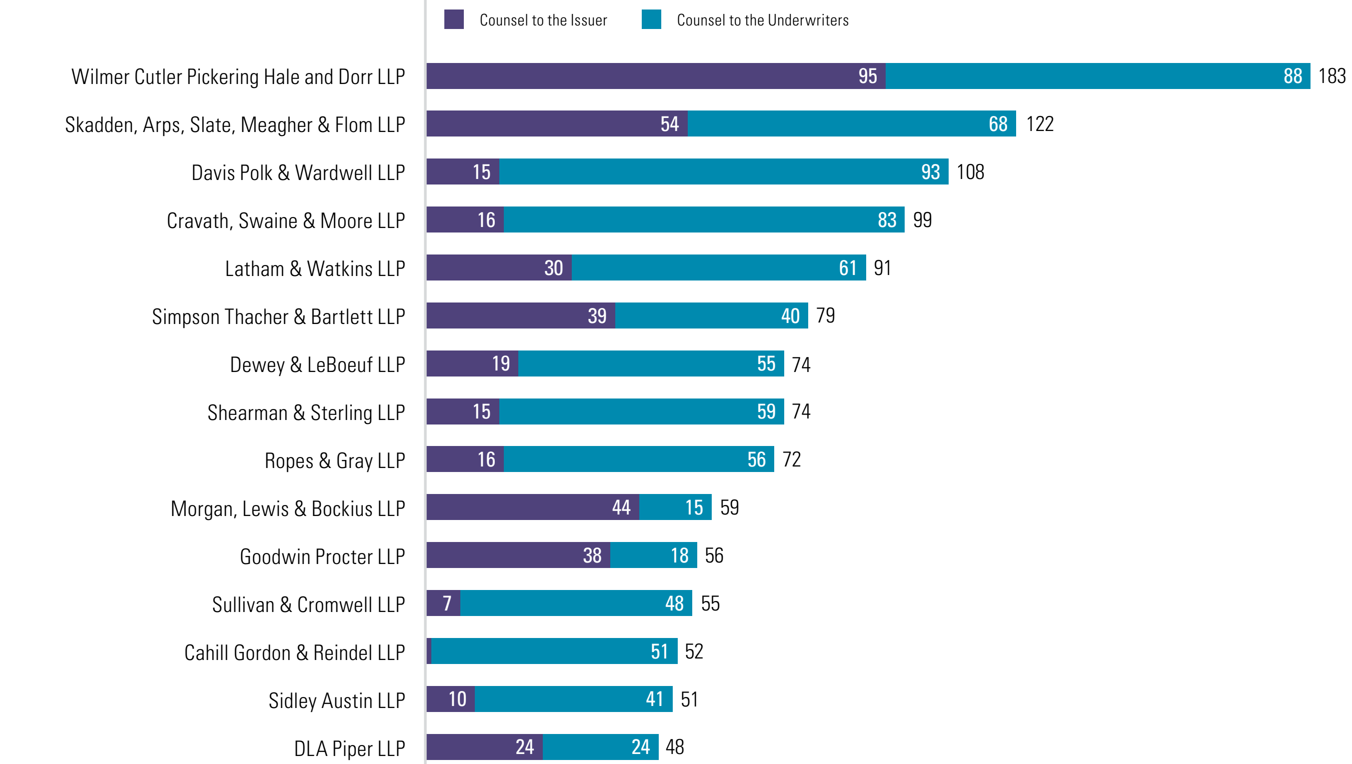
Set forth below are selected metrics about the IPO market, based on combined data for all US IPOs from 2007 through 2011.

Median offering size	$120.0 million (12% below $50 million and 9% above $500 million)
Median annual revenue of IPO companies	$96.6 million (29% below $50 million and 16% above $500 million)
Percentage of IPO companies that are profitable	62%
Aftermarket performance by year-end	11% average decrease from IPO price (2011) 28% average increase from IPO price (2010) 18% average increase from IPO price (2009) 36% average decrease from IPO price (2008) 15% average increase from IPO price (2007)
State of incorporation of IPO companies	Delaware—93% No other state over 1%
Percentage of IPOs including selling stockholders, and median percentage of offering represented by those shares	Percentage of IPOs—54% Median percentage of offering—33%
Percentage of IPOs including directed share programs, and median percentage of offering represented by those shares	Percentage of IPOs—46% Median percentage of offering—5%
Percentage of IPO companies disclosing adoption of ESPP	26%
Percentage of IPO companies using a "Big 4" accounting firm	79%
Stock exchange on which the company's common stock was listed	Nasdaq—58% NYSE—40% Other—2%
Median number of Form S-1 amendments (excluding exhibits-only amendments) filed before effectiveness	Five
Median IPO expenses	Legal—$1,333,000 Accounting—$824,000 Total—$3,100,000
Median underwriting discount	7%
Time elapsed from initial filing to effectiveness of the Form S-1	Median—112 calendar days 25th percentile—91 calendar days 75th percentile—173 calendar days

All IPO companies need top executive talent, a strong competitive position, adequate market capitalization and deal-savvy advisors, but other factors can vary based on a company's industry and size. For example, many biotech companies will have much smaller revenues and not be profitable. More mature companies are likely to have greater revenues and market caps, but slower growth rates. High-growth companies are likely to be smaller, and usually have a shorter history of profitability.

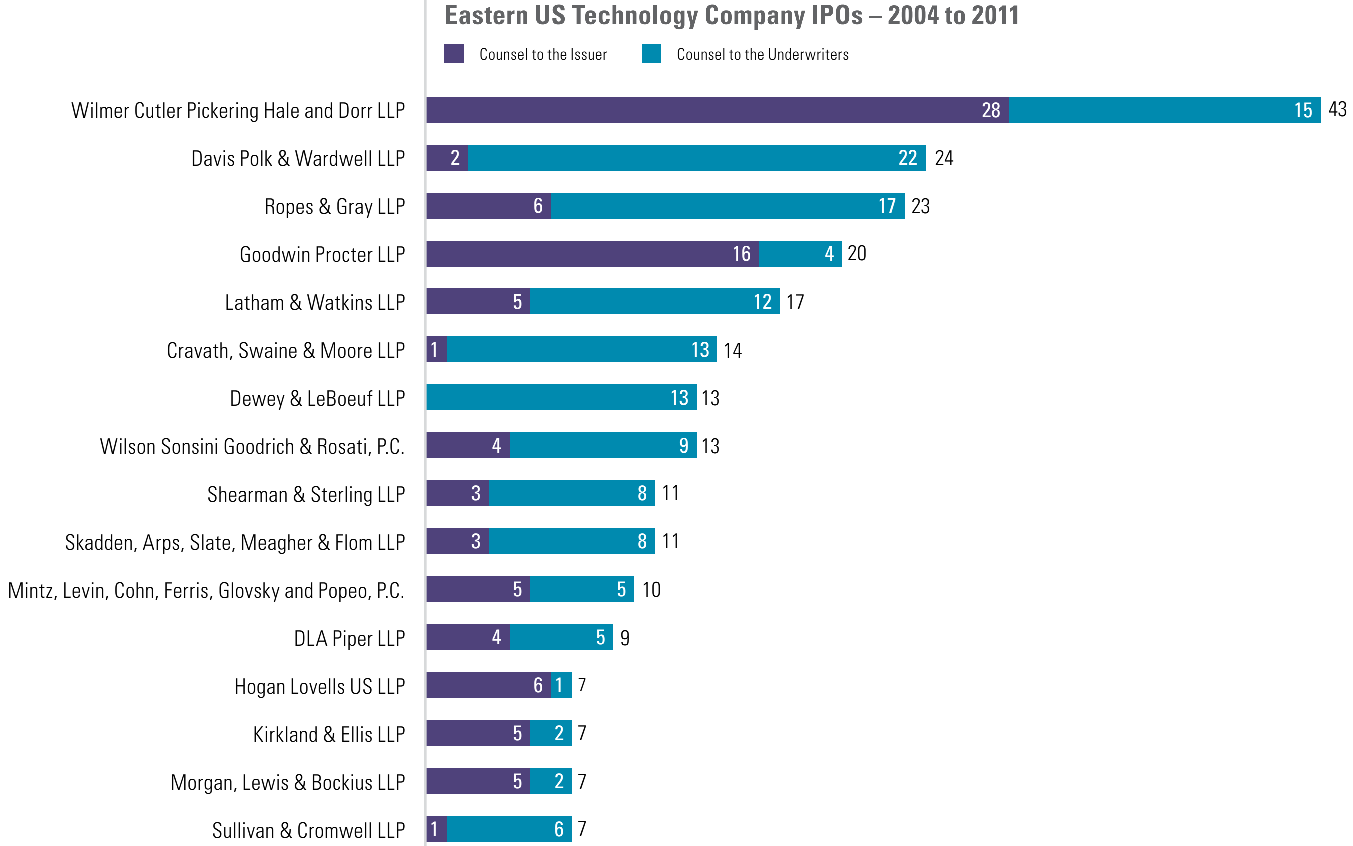
Beyond these objective measures, IPO candidates need to be ready for public ownership in a range of other areas, including accounting preparation; corporate governance; financial and disclosure controls and procedures; employee recruitment and retention; external communications; and a variety of corporate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

Eastern US IPOs – 1996 to 2011



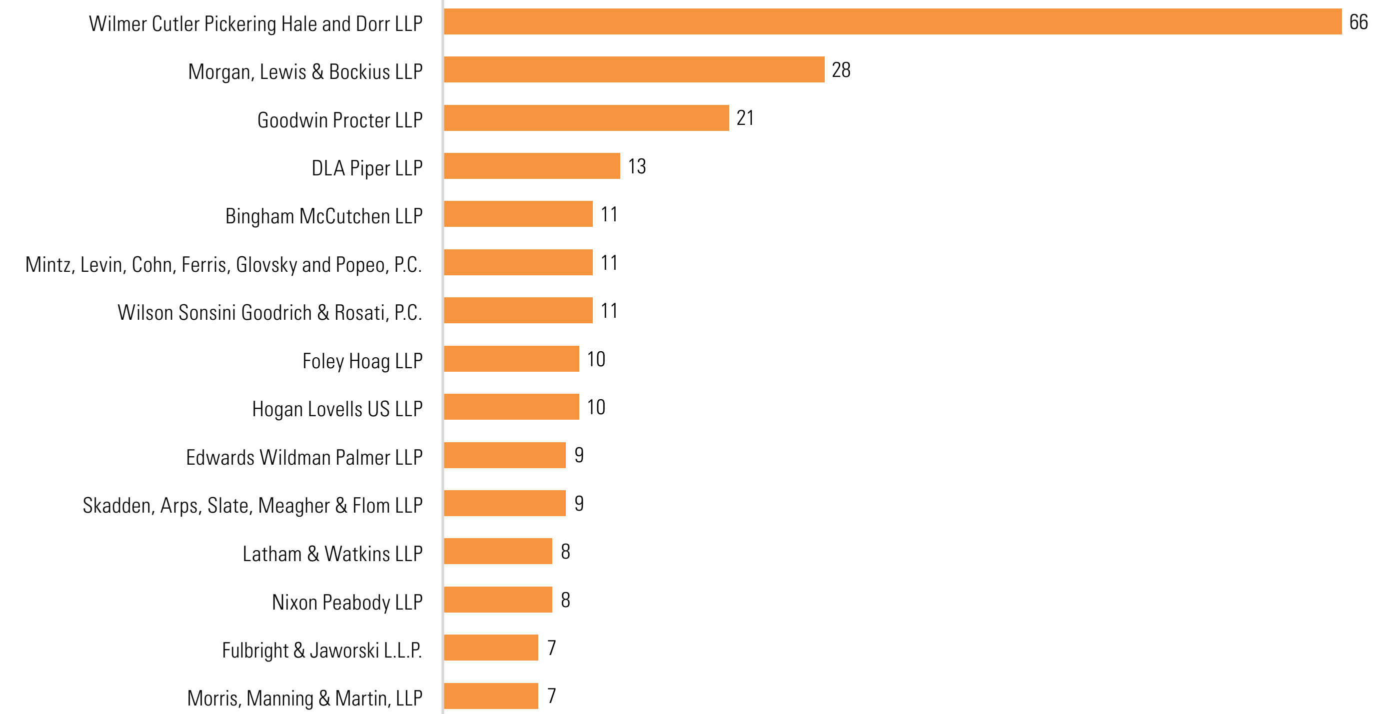
Source: SEC filings

Eastern US Technology Company IPOs – 2004 to 2011



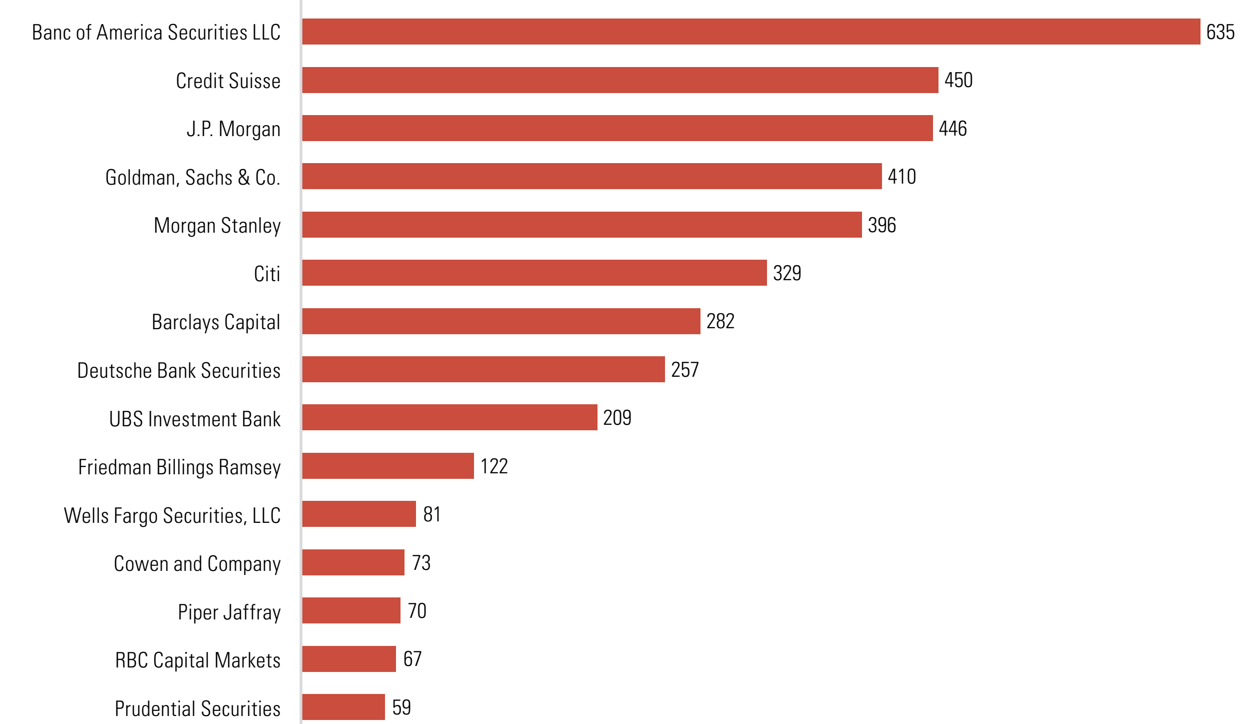
Source: SEC filings
The above charts are based on companies located east of the Mississippi River.

Company Counsel in IPOs of Eastern US VC-Backed Companies – 1996 to 2011



The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureOne and SEC filings

Bookrunner in US IPOs – 1996 to 2011



Source: Thomson Reuters

Counsel of Choice for Public Offerings

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

demandware
Initial Public Offering of Common Stock
$101,200,000
Counsel to Issuer
March 2012

Tangoe
Initial Public Offering of Common Stock
$100,855,000
Counsel to Issuer
August 2011

PerkinElmer
Public Offering of 5.00% Senior Notes
$500,000,000
Counsel to Issuer
October 2011

Sensata Technologies
Public Offering of Ordinary Shares
$663,000,000
Counsel to Underwriters
February 2011

ACCRETIVE HEALTH
Public Offering of Common Stock
$175,662,500
Counsel to Issuer
March 2011

Thermo Fisher SCIENTIFIC
Public Offering of Senior Notes
$2,100,000,000
Counsel to Issuer
August 2011

Verastem
Initial Public Offering of Common Stock
$63,250,000
Counsel to Issuer
January 2012

MERRIMACK PHARMACEUTICALS
Initial Public Offering of Common Stock
$105,297,000
Counsel to Issuer
April 2012

PHARMASSET
Public Offering of Common Stock
$175,822,000
Counsel to Underwriters
January 2011

Discovery COMMUNICATIONS
Public Offering of 3.30% and 4.95% Senior Notes
$1,000,000,000
Counsel to Issuer
May 2012

Aegerion Pharmaceuticals
Initial Public Offering of Common Stock
$54,625,000
Counsel to Underwriters
October 2010

KeneXa
Public Offering of Common Stock
$95,737,500
Counsel to Underwriters
May 2011

AMERESCO
Initial Public Offering of Common Stock
$90,397,000
Counsel to Issuer
July 2010

ACHILLION
Public Offering of Common Stock
$60,900,000
Counsel to Issuer
June 2011

SS&C
Public Offerings of Common Stock
$347,360,000
Counsel to Issuer
February and July 2011

PACIRA PHARMACEUTICALS, INC.
Initial Public Offering of Common Stock
$42,000,000
Counsel to Issuer
February 2011

Idenix PHARMACEUTICALS
Public Offerings of Common Stock
$124,958,000
Counsel to Issuer
April and November 2011

AVEO PHARMACEUTICALS, INC.
Public Offering of Common Stock
$111,162,000
Counsel to Issuer
June 2011

SAVIENT PHARMACEUTICALS, INC.
Public Offering of 4.75% Convertible Senior Notes
$230,000,000
Counsel to Issuer
February 2011

TARGACEPT
Public Offering of Common Stock
$86,250,000
Counsel to Underwriters
May 2011

STATE STREET
Public Offering of Senior Notes
$2,000,000,000
Counsel to Issuer
March 2011

UBIQUITI NETWORKS
Initial Public Offering of Common Stock
$121,409,500
Counsel to Underwriters
October 2011

GENPACT
Public Offering of Common Stock
$579,600,000
Counsel to Issuer
March 2010

Alnylam PHARMACEUTICALS
Public Offering of Common Stock
$92,719,000
Counsel to Issuer
February 2012

casella waste systems, inc.
Rule 144A Placement of 7.75% Senior Subordinated Notes
$200,000,000
Counsel to Issuer
February 2011

NuPathe
Initial Public Offering of Common Stock
$50,000,000
Counsel to Underwriters
August 2010

brightcove
Initial Public Offering of Common Stock
$63,250,000
Counsel to Underwriters
February 2012

Dean FOODS
Rule 144A Placement of 9.750% Senior Notes
$400,000,000
Counsel to Issuer
December 2010

EVERCORE PARTNERS
Public Offering of Common Stock
$178,489,000
Counsel to Underwriters
June 2011

Yandex
Initial Public Offering of Class A Ordinary Shares
$1,435,000,000
Counsel to Issuer
May 2011

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CALIFORNIA

The number of California IPOs grew from 20 in 2010 to 25 in 2011, a 25% increase, despite a decline in the overall US IPO market. Gross proceeds, however, surged 158%, from $1.95 billion to $5.04 billion, as a result of a number of large offerings.

California's largest IPO of 2011 was Zynga's $1.0 billion offering—the second-largest Internet IPO in history by a US-based issuer, trailing only the $1.67 billion IPO by Google in 2004 (until both were recently eclipsed by Facebook). Other large California IPOs in 2011 came from Air Lease Corporation ($802.5 million) and LinkedIn ($352.8 million—the fourth-largest Internet IPO ever by a US-based issuer).

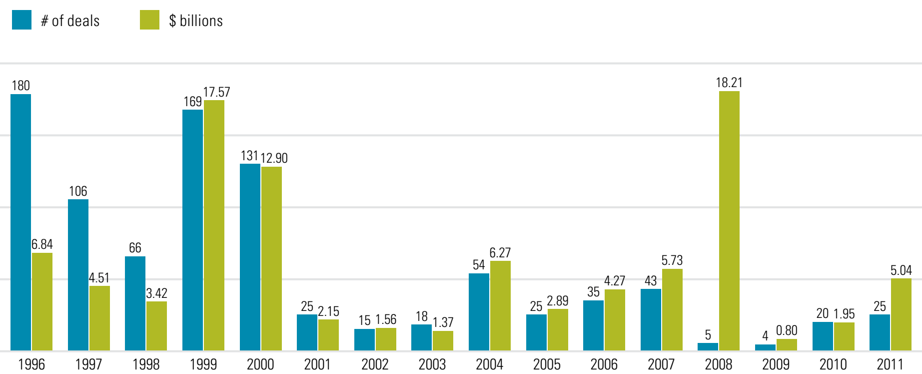
Despite the increase in IPO activity, the number of California IPOs in 2011 fell short of the annual average of 31 IPOs that prevailed between 2001 and 2007, before the California IPO market faltered in 2008 and 2009.

The California IPO market continued to be dominated by technology-related companies in 2011, with tech companies accounting for 84% of the state's offerings, compared to 53% of the overall US market. We expect this trend to continue in 2012.

Despite strong aftermarket performances by several California IPOs in 2011, the state's average IPO ended the year 5% below its offering price, and only eight California IPOs remained above their offering price at year-end. California's best performers of 2011 were Imperva (up 93%—the best-performing US IPO of the year), ServiceSource International (up 57%), Cornerstone OnDemand (up 40%) and LinkedIn (also up 40%).

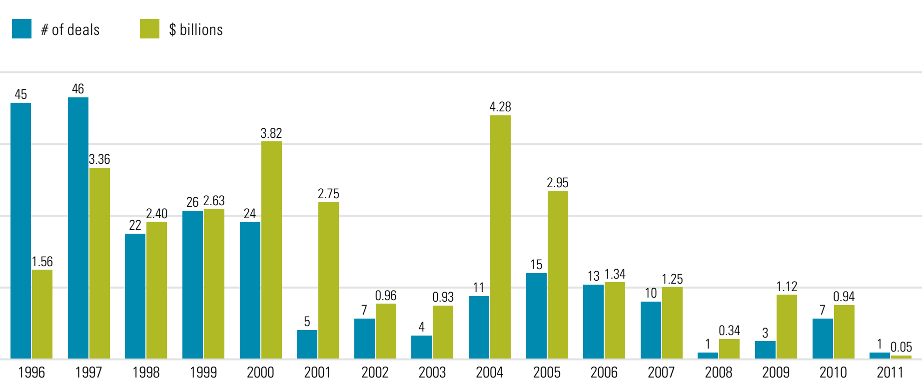
With stable capital market conditions, we expect California IPO activity in 2012 to surpass recent levels, and to include offerings from Internet, cleantech and alternative energy companies. The biggest highlight year-to-date—and the most prominent IPO of recent years—was Facebook's $16.0 billion IPO in May 2012.

California IPOs – 1996 to 2011



Source: SEC filings

Mid-Atlantic IPOs – 1996 to 2011



Source: SEC filings

MID-ATLANTIC

The mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia produced one solitary IPO in 2011, down from seven in 2010 and matching the region's recent low-water mark in 2008.

Technology- and defense-related companies historically have contributed a significant portion of the mid-Atlantic's IPO deal flow. The region's only IPO of 2011 came from biopharmaceutical company Tranzyme, whose $54.0 million IPO was priced well below the original range and traded down 28% by year-end.

We expect a rebound in mid-Atlantic IPO activity in 2012, as the region's annual average of three IPOs over the past four years has already been exceeded. Year-to-date highlights include the IPOs of Carlyle Group ($671.0 million), Millennial Media ($132.6 million), U.S. Silica Holdings ($200.0 million), and two biopharmaceutical companies: Cempra ($50.4 million) and Supernus Pharmaceuticals ($50.0 million).

NEW ENGLAND

New England produced six IPOs in 2011, equaling the region's total from the prior year. Gross proceeds dipped to $917 million, representing a 16% decline from the $1.09 billion raised in 2010.

Once again, Massachusetts led the region, with four IPOs in 2011, followed by Connecticut with two, as each state matched its 2010 tally.

While the New England IPO market has been historically dominated by technology company IPOs, tech companies accounted for only 50% of the region's total in 2011. The other three IPOs from the region came from consumer products and services companies.

The region's largest IPOs were by Dunkin' Brands Group ($422.8 million) and Zipcar ($174.3 million). Both had impressive first-day gains, of 47% and 56%, respectively—the sixth- and tenth-best first-day gains of the year—but lost ground in the aftermarket.

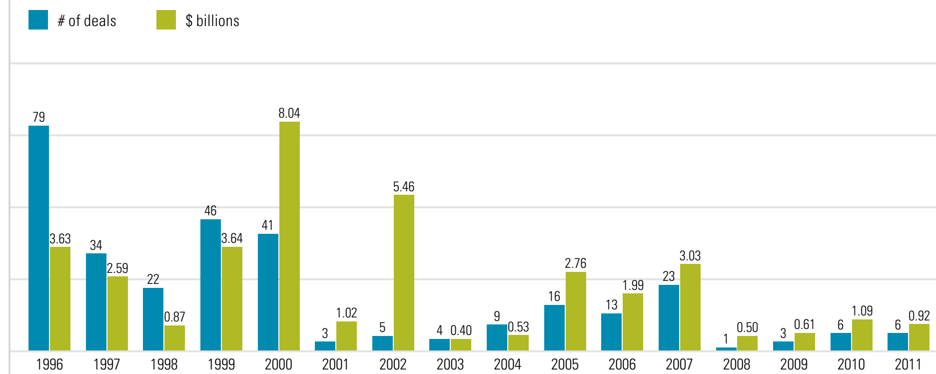
At year-end, the region's best-performing IPO of 2011 came from software company Tangoe—up 54% from its offering price. The average New England IPO in 2011 ended the year 10% above its offering price, but 13% below its first-day close.

New England's other 2011 IPOs came from BG Medicine ($35.0 million), Carbonite ($62.5 million) and The Chefs' Warehouse ($135.0 million).

With strong levels of venture capital investment and world-renowned universities and research institutions, New England should continue to provide a fertile environment for new companies and remain a natural wellspring of IPO candidates.

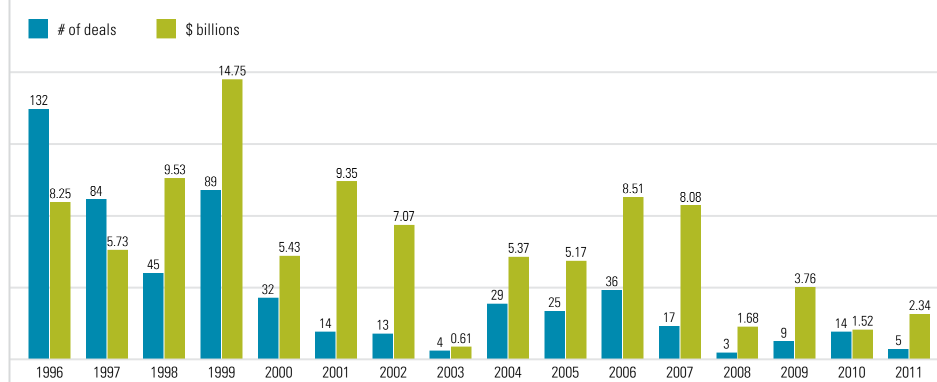
We anticipate a modest increase in the region's IPO volume in 2012. Year-to-date highlights include the IPOs of software companies Brightcove ($55.0 million) and Demandware ($88.0 million), biopharmaceutical companies Merrimack Pharmaceuticals ($101.0 million) and Verastem ($88.0 million), and M/A-COM Technology Solutions Holdings ($114.0 million).

New England IPOs – 1996 to 2011



Source: SEC filings

Tri-State IPOs – 1996 to 2011



Source: SEC filings

TRI-STATE

The number of IPOs in the tri-state region of New York, New Jersey and Pennsylvania fell from 14 in 2011 to five in 2012. Buoyed by the $1.64 billion IPO of Nielsen Holdings—the third-largest US IPO of the year—gross proceeds, however, increased 54%, from $1.52 billion in 2010 to $2.34 billion in 2011.

IPOs by tri-state companies in 2011 performed well in the aftermarket, gaining an average of 23% by year-end. GNC Holdings—despite an opening day increase of only 5%—increased 81% from its offering price by year-end and was the second-best-performing US IPO of the year.

Venture capital activity in the tri-state region now trails only that of California. We expect that VC-backed companies—including those from the consumer Internet, technology and life sciences sectors—will be IPO candidates in 2012 as the market continues to improve. Year-to-date highlights include the IPOs of EPAM Systems ($72.0 million), FX Alliance ($62.4 million) and Tumi Holdings ($338.0 million). ■

On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was enacted with great fanfare. Intended to spur job creation and economic growth by improving access to the capital markets for startup companies, the JOBS Act has broad implications for pre-IPO companies and the conduct of IPOs.

"IPO ON-RAMP"

Most notably, the JOBS Act seeks to improve access to capital for companies that qualify as "emerging growth companies" (EGCs). EGCs will have up to five years following their IPO to come into full compliance with certain disclosure regulations and accounting and auditing standards that are otherwise applicable to all US public companies.

An EGC is any issuer that had total annual gross revenues of less than $1 billion (indexed for inflation) during its most recently completed fiscal year, other than an issuer that completed its IPO on or before December 8, 2011. Emerging growth company status ends after five years, or earlier if the company's annual revenues reach $1 billion (indexed for inflation); the company has been public for at least 12 months, files one Form 10-K, and achieves a public float of at least $700 million; or the company issues more than $1 billion in non-convertible debt during a three-year period. During this phase-in or "IPO on-ramp" period, an EGC will enjoy the following exemptions from, and modifications of, current disclosure requirements and accounting and auditing standards:

- *Reduced Financial Statement and MD&A Disclosure:* In IPO registration statements, EGCs are required to provide only two years of audited financial statements (instead of three), plus unaudited interim financial statements. In addition, an EGC need not present selected financial data in other registration statements or Exchange Act reports, such as Annual Reports on Form 10-K, for any period prior to the earliest audited period presented in its IPO registration statement. Similarly, an EGC is only required to include in registration statements and Exchange Act reports Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) for the fiscal periods presented in the required financial statements.
- *Exemption from Internal Controls Audit Attestation:* EGCs are exempt from the requirement under Section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company's internal control over financial reporting (ICFR).

  As a practical matter, IPO companies will still need to implement robust controls and procedures prior to going public, because an EGC's CEO and CFO will be required to provide certifications with respect to the EGC's disclosure controls and procedures and ICFR starting immediately after going public, and because such controls will help enable the EGC to prepare its financial statements, withstand underwriter due diligence and support the representations contained in the IPO underwriting agreement.
- *Delayed Application of New Accounting Standards:* EGCs may choose not to be subject to any accounting standards that are adopted or revised on or after April 5, 2012, until these standards are required to be applied to non-public companies (companies that are not subject to the reporting requirements of the Exchange Act and have not filed a pending registration statement under the Securities Act). Only accounting standards that apply to non-public companies are eligible for delayed application; an EGC must immediately comply with accounting standards that do not apply at all to non-public companies. This election must be made on an "all or nothing" basis; a decision not to adopt the extended transition is irrevocable.

  It is unclear whether opting out will always be beneficial to an EGC, however, as it may make the ultimate transition out of EGC status more painful (both from a technical accounting perspective and due to the need to reset market expectations/guidance at a time when the EGC is already a public company). An EGC that chooses to take advantage of the extended transition periods for any recently issued accounting standards should disclose in each registration statement or Exchange Act report that requires disclosure with respect to recently issued accounting standards the date on which adoption of such standards is required for non-EGCs and the date on which the EGC will adopt each such standard, assuming it remains an EGC as of such date.
- *Exemption from New PCAOB Audit Requirements:* EGCs are exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company (a so-called auditor discussion and analysis) that the Public Company Accounting Oversight Board (PCAOB) might adopt. Any other new auditing standards adopted by the PCAOB will not apply to audits of EGCs unless the SEC determines that application of the new rules to audits of EGCs is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition and capital formation.
- *Reduced Executive Compensation Disclosures:* An EGC is allowed to provide the "scaled" executive compensation disclosures previously available only to companies with a public float of less than $75 million. As a result, an EGC need not provide Compensation Discussion and Analysis (CD&A); compensation information is required only for three named executive officers (including the CEO); only three of the seven compensation tables otherwise required must be provided; and the Summary Compensation Table is only required to cover two years (as opposed to three).
- *Exemption from Additional Compensation Disclosures:* EGCs are exempt from the Dodd-Frank Act requirements, which remain subject to future SEC rulemaking, to include disclosures about the relationship between executive compensation and financial performance and the ratio between CEO compensation and median employee compensation.
- *Exemption from Say-on-Pay Advisory Votes:* EGCs are exempt from the requirements mandated by the Dodd-Frank Act that companies seek stockholder approval of an advisory vote on their executive compensation arrangements, including golden parachute compensation.
- *Expansion of Permitted Investor Communications:* EGCs and their agents have more freedom to communicate with potential investors that are qualified institutional buyers (QIBs) or institutional accredited investors (IAIs), both before and after the filing of a registration statement for an IPO or other securities offering (including during the quiet period).

  While this change will not eliminate all gun-jumping concerns, it should significantly reduce the risks, so long as the EGC limits its discussions to QIBs and IAIs and avoids media communications. This change is also likely to accelerate the existing trend of "non-deal road shows" (which are currently structured to occur more than 30 days before the initial Form S-1 filing and cannot include discussion of the offering, and generally do not include written materials) and "preliminary road shows" (which are currently structured to occur after the initial Form S-1 filing and cannot include written materials). It also means that underwriter outreach to potential investors in advance of the availability of a preliminary prospectus containing a price range will not constitute an unlawful offer, as long as only QIBs and IAIs are contacted and the communications are authorized by the company.
- *Confidential Submission of Registration Statements:* An EGC is able to submit a "draft" Form S-1 to the SEC for confidential review instead of filing it publicly on the SEC's EDGAR system (and may switch a pending Form S-1 public filing to a confidential submission). A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements and signed accountant's audit reports, but need not be signed by the EGC, include consents from accountants or other experts, or be accompanied by the registration fee (required signatures, consents and the registration fee are provided upon the first public filing). The SEC review process for a confidential submission is the same as for a public filing. Confidential submissions are exempt from Freedom of Information Act requests, but have to be filed publicly no later than 21 days before the road show commences. The confidential submission process is not available for a Form 10 registration statement filed under the Exchange Act.

  Confidential submission enables an EGC to maintain its IPO plans in secrecy and delay disclosure of sensitive information to competitors and employees until much later in the process. It also extends the time period during which the EGC may rely on the Rule 163A safe harbor from gun-jumping violations. Depending on the timing, confidential review also means that the EGC could withdraw the registration statement without any public disclosure at all if, for example, the SEC raises serious disclosure issues that the EGC does not want made public or market conditions make it apparent that an offering cannot proceed. Confidential submission will, however, delay any perceived benefits of public filing, such as favorable publicity or the attraction of potential acquirers.

ADOPTION OF EGC STANDARDS

An EGC may choose to forgo any of the exemptions provided to EGCs and instead comply with the requirements that apply to a company that is not an EGC. An important limitation on this right to "opt in" to non-EGC standards is that an EGC must decide whether it will avail itself of the exemption regarding the extension of time to comply with new and revised accounting standards at the time the company is first required to file a registration statement or other report with the SEC after April 5, 2012. Furthermore, an EGC is not permitted to choose to comply with some but not all of the non-EGC accounting standards. An EGC that adopts the extended transition period may subsequently opt in to the non-EGC standards.

Eligible companies that adopt EGC standards should explain that they are providing EGC disclosures in their public filings. The SEC staff has indicated that an EGC should indicate its EGC status on the cover of its IPO prospectus (whether or not the company is taking advantage of any of the benefits available to EGCs). EGCs should also include risk factor disclosure concerning EGC standards that create additional risk for investors, such as the absence of an ICFR audit or the delayed application of new accounting standards to the EGC.

Although the overwhelming majority of all IPO companies are likely to qualify as EGCs—approximately 90% of all IPO companies over the past five years would have qualified as EGCs—the extent to which EGC standards will be adopted by eligible companies and accepted by the market is uncertain. Institutional investors could, for example, demand that EGCs continue to comply with non-EGC standards for some or all matters. A pre-IPO EGC should consider market and investor expectations before adopting EGC standards, and should discuss with its IPO underwriters the impact of adopting EGC standards on the marketability of the offering.

An EGC that is already on file for an IPO may adopt EGC standards in its next Form S-1 amendment. In doing so, however, the EGC must be careful that the omission of information in reliance on EGC standards is not misleading. The SEC staff has indicated, for example, that it is likely to comment if an EGC in registration drops information whose omission may be misleading—such as the third year of financial statements, where that year reflects poor results, while the financial statements for the more recent two years reflect strong results—without addressing the issue through other disclosure.

SEC RULEMAKING AND MARKET PRACTICES

The JOBS Act was created by combining various legislative proposals that had been under consideration by Congress over the past year or so. In addition to the rulemaking required by the JOBS Act, the SEC staff has begun issuing "Frequently Asked Questions" to provide guidance on the implementation and application of the act, but many questions remain. Moreover, market practices with respect to the JOBS Act are only just beginning to emerge. The ultimate implications of the JOBS Act will become known over time as SEC rulemaking and interpretations continue and market practices develop. ■

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

JOBS ACT

If a company appears to qualify as an "emerging growth company" (EGC) under the recently enacted Jumpstart Our Business Startups Act (JOBS Act), the staff will ask the company to disclose on the prospectus cover that it is an EGC. The staff will also ask the company to describe how and when it may lose EGC status; describe the various exemptions that are available to it as an EGC; and, if it has elected to use the extended transition period for complying with new or revised accounting standards, indicate that its financial statements may not be comparable to those of public companies that do comply with such accounting standards.

QUIET PERIOD

After a company files a Form S-1, the SEC routinely reviews press releases, newspaper and magazine stories, and the Internet, including the company's website, to determine whether the company has violated the SEC's quiet-period restrictions. Common sources of violations include interviews (particularly because the company cannot control the timing or content of publication); social media (when used to discuss the company's IPO plans externally); and widespread employee communications (when not effectively confined to an internal audience). Quiet period concerns can result in offering delays and undesirable prospectus disclosures.

NON-GAAP FINANCIAL MEASURES

Although the SEC's revised interpretive guidance issued in January 2010 is more tolerant of the use of non-GAAP financial measures, including in IPOs, the staff insists on compliance with the applicable rules and will object to the use of non-GAAP financial measures it considers misleading. For example, staff views the exclusion of recurring operating expenses with skepticism.

MD&A

Topics of staff focus in MD&A include the key metrics used by management to monitor and evaluate the company's financial condition and operating performance; known trends and uncertainties; revenue recognition; segment disclosures; "cheap stock" methodologies and disclosures (including common stock fair value determinations in the prior 12–18 months and justification of the step-up from the most recent fair value determination to the mid-point of the estimated offering price range); and acquisition accounting.

"FLASH RESULTS"

The inclusion of estimated financial results for a recently completed fiscal period ("flash results") will draw staff scrutiny: the presentation must be balanced and not misleading; both revenue and income metrics are typically necessary; if ranges are used, they must be narrow; and the basis for the numbers in the ranges must be explained. Flash results for the fourth fiscal quarter are particularly challenging.

EXECUTIVE COMPENSATION DISCLOSURES

Typical staff comments request more analysis in CD&A of the reasons for specific compensation decisions; a description of the CEO's role in determining compensation of other executive officers; the identification of peer companies used for benchmarking; and disclosure of the quantitative performance targets used for incentive compensation. (EGCs need not provide a CD&A.)

RELATED PERSON TRANSACTIONS

The staff is very attuned to the nature and placement of disclosures concerning related person transactions. For example, if an insider intends to purchase shares in the offering, the staff may require that appropriate disclosure be added to the prospectus cover. Material relationships between the company and the underwriters or selling stockholders also need to be disclosed.

STOCKHOLDER RIGHTS

The staff's longstanding requirement to disclose the impact of anti-takeover provisions is extending to new techniques affecting stockholder rights, such as dual-class or tri-class capital structures and the inclusion of "exclusive forum" provisions in the corporate charter or bylaws.

RECURRING DRAFTING COMMENTS

Although the following comments usually can be anticipated and avoided, the staff continues to request that companies:

- Condense the prospectus summary and make it more balanced
- Tailor the risk factors to the specifics of the company
- Eliminate industry and technical jargon
- Substantiate leadership claims and other assertions
- Reconcile inconsistencies within the prospectus and when compared to the company's website
- Remove disclaimers and mitigating language
- Provide the staff with industry research reports cited in the prospectus and file consents for any reports that are not publicly available
- Add explanations provided in response letters to the prospectus ■

SEC Review: What to Expect

- Initial comment letter, containing about 40–60 comments, in 27–30 days
- Total of 4–5 comment letters, with fewer comments and quicker turnaround each time
- Overall, comments focus on financial statements (17%), MD&A (14%), risk factors (10%), summary (10%), business (10%) and executive compensation (8%)

The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) requires that proposed acquisitions of voting securities—of any issuer, public or private—meeting certain size thresholds be reported to the federal antitrust authorities prior to consummation. While corporate acquirers are usually aware of HSR Act filing obligations, individual acquirers often are not. Moreover, a filing obligation can be triggered by the acquisition of voting securities as part of an executive's routine compensation if the acquisition results in the executive's total holdings of the issuer's voting securities exceeding a minimum threshold (currently $68.2 million)—leading to the potential for inadvertent HSR violations and hefty penalties.

APPLICATION TO INDIVIDUAL'S ACQUISITIONS

The HSR Act requires acquirers of "voting securities" (any securities that provide the holder with the right to vote for the issuer's directors) to report transactions that satisfy specified thresholds to the DOJ and FTC and to observe a mandatory waiting period before consummating the transaction. Unlike the SEC rule that deems a person the beneficial owner of all shares the person has the right to acquire within 60 days, for HSR purposes voting securities are not considered acquired simply because a person has the right to acquire them in the future. For example, the exercise of a stock option—rather than receipt of the option—is treated as the acquisition of a voting security.

If applicable size thresholds are satisfied, the HSR Act may require an executive to report routine transactions, such as the acquisition of shares through executive compensation programs, the exercise of stock options, the purchase of securities on the open market, the conversion of non-voting shares into voting shares, the vesting of restricted stock units, or the reinvestment into shares of dividends or interest earned through a company 401(k) plan.

HSR reporting also requires payment of a filing fee of $45,000 to $280,000, depending on the size of the reporting threshold.

THRESHOLDS FOR HSR REPORTING

The HSR reporting thresholds are the same for individual acquirers and corporate acquirers. These thresholds include a "size-of-transaction" test and a "size-of-person" test. Reporting and exemption thresholds under the HSR Act are adjusted annually; the current thresholds became effective on February 27, 2012.

- *Size-of-Transaction*: An acquisition may be reportable if the individual will hold at least $68.2 million in voting securities of the issuer after the transaction is complete. An individual's holdings is taken to include those of the individual's spouse, minor children and any entities that they "control." A person "controls" a corporation if he or she holds 50% or more of its voting securities or has the contractual right to appoint at least 50% of its directors, and a person "controls" a non-corporate entity if he or she has the right to 50% or more of its profits or at least 50% of its assets upon dissolution. (Additional rules apply to control of trusts.) For purposes of this test, the HSR Act requires that the value of shares held before the transaction be added to the value of the shares to be acquired; previously held shares are valued at their current value regardless of their original acquisition date or value.
- *Size-of-Person*: If the value of voting securities held as a result of the transaction exceeds $272.8 million, the individual's income or assets are irrelevant. However, for transactions resulting in shareholdings between $68.2 million and $272.8 million, the acquirer also must meet a size-of-person test, which requires the individual to have annual income or assets of at least $13.6 million. For this purpose, if the individual (and his or her spouse and minor children) do not prepare balance sheets in the regular course of business and do not control any entity that prepares such balance sheets, the individual will *not* have to include the value of his or her existing shareholdings in the issuer. The executive will, however, have to include existing shareholdings in the size-of-person analysis if he or she does keep regular balance sheets.

The HSR Act's mandatory waiting period ends 30 days after filing, unless the antitrust agencies grant early termination or request more time for investigation. Once an individual makes an HSR filing and the waiting period lapses, he or she is free to continue to acquire voting securities of the same issuer for five more years without making any additional filings, as long as the acquisitions do not exceed the next reporting threshold.

EXEMPTIONS

Some transactions are exempt from reporting requirements:

- Individuals need not report transactions that will not result in a net increase in the individual's percentage ownership of voting securities. This can occur, for example, if the company simultaneously issues enough shares to other stockholders that the acquirer's overall ownership does not increase.
- An individual need not report acquisitions if he or she already owns 50% or more of the entity's voting securities.
- Passive investors need not report acquisitions solely for investment purposes if the transaction results in the acquirer holding no more than 10% of the issuer's voting securities and the acquirer does not participate in the issuer's basic business decisions. The passive investor exemption is not available to officers and directors of the issuer.

In addition, the HSR Act requires individuals to report the acquisitions of voting securities of non-corporate entities, such as LLCs or partnerships, only if the acquirer is entitled to 50% or more of the entity's profits or at least 50% of the entity's assets upon dissolution.

PENALTIES AND CORRECTIVE FILINGS

The DOJ and FTC can impose penalties of up to $16,000 per day for failure to report a transaction. Penalties typically are not imposed on an individual acquirer for a *first-time*, inadvertent failure to file if the individual notifies the agencies and submits a corrective filing as soon as possible. In late 2011, however, the antitrust authorities imposed a $500,000 penalty on a corporate executive who apparently was viewed as a repeat offender. ■

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

Our *2012 Venture Capital Report* offers an in-depth analysis of, and outlook for, the US and European venture capital markets. The report features industry and regional breakdowns, an analysis of trends in venture capital financing and VC-backed company M&A deal terms, a look at the 2012 JOBS Act's loosening of fundraising restrictions on private companies, and an overview of a recent IRS program to address the misclassification of independent contractors.

See our *2012 M&A Report* for a detailed review of, and outlook for, the global M&A market. Other highlights include a comparison of public and private acquisitions, a look at takeover defenses adopted by public companies, and a survey of key terms in sales of VC-backed companies.

To request a copy of any of the reports described above, or to obtain additional copies of the *2012 IPO Report*, please contact the WilmerHale Marketing Department at WHCorporateReports@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at wilmerhale.com/2012IPOreport.

Data Sources

WilmerHale compiled all data in this report unless otherwise indicated. Offerings by REITs, bank conversions, closed-end investment trusts and special purpose acquisition companies are excluded from IPO data. Offering proceeds generally exclude proceeds from exercise of underwriters' over-allotment options, if applicable. For law firm rankings, IPOs are included under the current name of each law firm. Venture capital data is sourced from Dow Jones VentureOne. Private equity–backed IPO data is sourced from Thomson Reuters.

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