

[COMPANY NAME]

PRE-OFFERING PLANNING

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PRE-OFFERING PLANNING

- I. Organizational Structure Suitable for an Initial Public Offering.**
 - A. Objective – Single corporation or corporation with subsidiaries
 1. Understandable to the public
 2. Easy to describe
 3. No place to hide insider transactions
 4. Definition of “we,” “our” and “us”
 - B. Structures likely to be troublesome
 1. Brother/sister corporations with common ownership
 2. Partnerships or trusts
 3. Combinations of other miscellaneous business entities
 - C. Methodology
 1. Mergers
 2. Liquidations
 3. Capital contributions
 4. Exchange offerings for partnerships
 - D. Reincorporation – typically to Delaware

II. Capital Structure Suitable for a Public Company.

- A. Stock split or reverse stock split
 - 1. Achieve appropriate price for the offering
 - a. Avoid appearance of “penny stock”
 - b. Achieve minimum price required by institutional investors
 - c. Avoid making a “round lot” too expensive
 - 2. Have sufficient shares for an adequate “float”
 - a. Aftermarket trading
 - b. Drop price to achieve
- B. Conversions of preferred stock or debt
 - 1. Automatic conversion provisions of governing instruments
 - a. Firm commitment underwriting
 - b. Total proceeds of at least \$____
 - c. Per share price of at least \$____
 - d. Possible need to amend Articles of Incorporation
 - 2. Redemption to force conversion
 - a. May or may not be viable, depending on company's cash

- b. Not typically done
 - 3. Negotiate
 - 4. Complete process prior to filing registration statement
- C. Investors' rights
 - 1. Need to review all rights, especially registration rights
 - 2. Provide enough notice to force issue
 - 3. There are tradeoffs on timing of registration rights notices
 - a. Prefer not to announce offering too soon
 - b. Like to give copy of registration statement
 - c. Like to describe in preliminary prospectus who is selling
 - d. "Quiet Filing"
 - 4. May ask for waivers or just announce that underwriters insist on "full cutback"
 - 5. Will want most other investors' rights to go away after offering
- D. Increase the authorized number of shares
 - 1. Usually want several times outstanding fully diluted shares
 - 2. Need shares available for stock splits, acquisitions, benefit plans, etc.

3. Easier to do as private company -- avoid wide circulation and proxies
 4. “Blank check” preferred – useful for acquisitions, later financings, etc.
- E. Share overhang
1. Shares freely transferable under Rule 144 one year after purchase
 2. Shares transferable after six months once Rules 701 and 144 become generally available (90 days after offering date)
 3. Stand-back or lock-up agreements
 - a. Contract not to sell for X days after IPO (typically 180 days plus extensions per NASD Rule 2711(f))
 - b. Company should seek these agreements in all documents – financing, benefit plans, etc.

III. Articles of Incorporation and By-laws.

- A. Revise to achieve additional flexibility
- B. Remove archaic provisions (e.g., preemptive rights, rights of first refusal)
- C. Delete all unneeded provisions (e.g., close corporation)
- D. Alter special voting provisions, super-majorities, class votes
- E. Anti-takeover considerations (e.g., add staggered board, supermajority or “fair price”; remove action

by written consent or ability to call special meeting; put poison pill in place)

1. In strong markets, anti-takeover provisions are not normally a problem, but in weaker markets when people have to be long-term holders, such provisions may be more difficult to sell
2. Do not make changes without underwriters' knowledge

F. Remove cumulative voting

IV. Accounting Issues.

A. Selection of auditing firm

1. SEC knowledge and procedures (Regulation S-X, comfort letter, controls)
2. Well-known name for prospectus
3. Assurance going forward

B. Early work on audits, if not previously done, could well be a pacing item

1. Uncover problems early – acquisitions, mergers, pro formas (Regulation S-X, Rule 3-05 and Article 11), revenue recognition issues
2. Make sure an unqualified opinion can be given – if not, additional disclosure required

C. Make sure accounting controls are in place

1. Review management letters; focus on material weaknesses
 2. Establish internal control systems to comply with Section 404 of Sarbanes-Oxley Act
- D. Do financial parameters qualify company for Nasdaq or exchange listing
- E. Are any subsidiaries “significant”?

V. Management.

- A. Adequate backgrounds – very important to venture capitalists, usually in place by offering time for larger deals
1. Balancing technical with financial, marketing, etc.
 - a. Prior public company/SEC reporting experience?
 - b. Are there notable gaps?
 2. Outsiders for Board – expertise, cosmetics, NASDAQ Global Market/exchange and SEC disclosure requirements
 - a. Three independent directors
 - b. Majority of independent directors
 - c. “Financial expert” for audit committee
- B. How does management stack up against public company requirements?

1. Burdens and responsibilities of being public
 - a. Will they really accept public mode
 - b. Can't be a fiefdom
 - c. Continuing education
 - i. Earnings announcement practices, Regulation FD
 - ii. Section 16(b), Rules 701 and 144, insider trading, etc.
 - iii. All the SEC filings
2. Regular reporting requirements
 - a. Is staff in place to do proper reporting?
 - b. Implementation of “disclosure controls and procedures”
3. Create audit, compensation, nominating/governance and other applicable committees
 - a. NASDAQ Global Market and exchange requirements
 - i. Audit committee of at least three independent directors; one should be “financial expert”
 - ii. Compensation committee/function

- comprised solely of independent directors
 - iii. Nominating/governance committee/function comprised solely of independent directors
 - iv. Transition rules ease burden
 - b. Other committees needed?
 - c. Committee charters
- 4. Adoption of corporate policies
 - a. Codes of conduct and ethics
 - b. Insider trading policy
 - c. Whistleblower policy
 - d. Governance principles/guidelines?
 - e. Communications policy?
- C. Enter into, revise or terminate employment agreements
- D. Director and officer insurance/indemnification
- E. Director and officer questionnaires

VI. Employee Benefit Plans.

- A. Adopt or revise plans
 - 1. Adopt new or amend existing option plan

- a. Increase number of shares reserved
 - b. Add features appropriate to public company (e.g., automatic grants to directors)
 2. Section 423 employee stock purchase plan or possibly a directors stock option plan
 3. Terminate rights of first refusal/repurchase rights
 - a. Why are these there originally?
 - b. Are they still needed?
 4. Build in stand-backs?
 - a. Long before time of offering if possible
 - b. S-8/stand-back tradeoff
- B. Grants to requisite people
1. Pricing issues (for fair market value)
 - a. Distance from offering/ changes in condition
 - b. Accounting issues – cheap stock/beneficial conversion premium
 - c. Valuation by independent firm
 2. Blue sky issues on volume of options
 - a. 10% or higher test – a number of states

- b. Solved by NASDAQ Global
Market/exchange listing
- C. Confirm no violation of Rule 701 limits
- D. Advise all employees regarding tax and securities
issues relating to exercise
 - 1. Hold meetings to explain and answer
questions
 - 2. Memoranda – Rule 144, Section 16 filings
and liability, ISOs, alternative minimum
tax, tax/securities interplay, insider trading

VII. Stock Issues.

- A. Prepare new stock certificates
 - 1. Meet state law standards
 - 2. Meet public trading standards
 - 3. CUSIP number
 - 4. Transfer agent
- B. Select bank note company
- C. Select transfer agent and registrar
- D. Printer
- E. Reserve trading symbol

VIII. Insider Transactions.

- A. Leases, loans, guarantees, etc.

- B. Eliminate as possible and desirable
 - 1. Sarbanes-Oxley Act requires elimination of insider loans before filing
- C. Revise to make other insider transactions “fair” if not so now
- D. Revise or cancel agreements among stockholders
- E. Establish procedures for future approvals

IX. Tax Issues.

- A. Filing of federal and state income tax returns
- B. Filing of sales tax returns
 - 1. Contingent liability
 - 2. Exposure at time you qualify to do business
- C. Tax loss carryforwards – § 382

X. Litigation.

- A. Ability to settle and eliminate before first filing
- B. Leverage given to the other side

XI. Prefiling Publicity.

- A. Establish course of conduct
- B. Product announcements and other press releases
- C. Interviews, seminars, analysts’ meeting

- D. Web site review
 - 1. Press releases
 - 2. Links to other web sites
 - 3. Content of the site
- E. Communications with potential purchasers through directed shares program
- F. More than thirty days before filing safe harbor, but don't mention the offering, and take necessary steps to prevent further dissemination during the 30-day period

XII. Cash Flow Projections.

- A. Predictable and profitable business model?
- B. Evaluate need for funds
- C. Have a reserve, so choosing to abort the offering is a real alternative
- D. Pricing of the offering itself – projections with which you can really live
- E. Need to avoid surprises in first public quarter

XIII. Qualifications to do Business in Other States.

XIV. Due Diligence Requests and Registration Statement Exhibits.

- A. Prepare due diligence requests
- B. Review diligence materials, including material contracts

- C. Evaluate disclosure issues
- D. Allow time to request any needed confidential treatment for documents to be filed
- E. Get all documents to be filed as exhibits
EDGARized