

**Morgan Lewis**

# **STARTUP & ACCELERATE**

**Initial Public Offerings (IPOs) – A Path to  
Liquidity for Founders and Venture Capital  
Funds Investing in High-Growth Companies**

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**Bryan S. Keighery and Alexandra M. Good**

# Presenters



Bryan S. Keighery



Alexandra M. Good

**Morgan Lewis**

# Before we begin

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# Pros of an IPO

- Greater access to capital, of particular importance for compliance with regulatory capital requirements
- Utilizing equity as incentive compensation with liquidity
- Stock value appreciation if stock performs well
- Liquidity for shareholders with equity and potential exit strategy
- More media and public attention (increased prestige)
- Facilitates future acquisitions (with the use of stock)

# Pros of an IPO

- Higher valuations than private enterprises (due to liquidity and transparency)
- Enhances ability to benchmark against peers
- Retains future upside potential in business
- Increases opportunities for reducing debt or refinancing
- Improved prospects for attracting and retaining key personnel

# Cons of an IPO

- IPO expenses – legal, accounting, underwriting, travel and printing costs
- Time-consuming
- Filing and reporting requirements – high continuing costs
- Ownership dilution
- Potential stock price manipulation - shorts
- Loss of confidentiality
- Significant public scrutiny

# Cons of an IPO

- Increased litigation risk
- Limits freedom of management to act – required transparency
- Potential loss of control (e.g., dilution of current stockholder interest, risk of takeover)
- Shareholder expectations (e.g., risk of focus on short-term stock price performance versus building long-term value)
- Difficulty recruiting good non-executive directors

# Cons of an IPO

- Meeting corporate governance requirements
- Require build out of functions such as investor relations, SEC reporting and human resources
- Acquiring another Federal regulator (the SEC)
- Materially increased regulatory liability for issues



# IPO Costs

Figure 4. Summary of going public costs

Average costs by revenue range					
Cost Category	Less than \$100m	\$100m to \$250m	\$250m to \$500m	\$500m to \$1bn	Greater than \$1bn
Accounting	0.8	1.2	1.3	1.8	1.9
Legal	1.5	1.9	2.0	3.0	3.0
Printing	0.3	0.4	0.5	0.6	0.6
Other*	0.5	0.8	0.9	1.2	1.6
Underwriting	6.9	10.4	17.4	20.2	27.5
<b>Total Avg IPO cost</b>	<b>10.1</b>	<b>14.6</b>	<b>22.1</b>	<b>26.5</b>	<b>34.3</b>

Average costs by proceeds raised					
Cost Category	\$25m to \$100m	\$100m to \$250m	\$250m to \$500m	\$500m to \$1bn	Greater than \$1bn
Accounting	0.8	1.1	1.7	1.4	2.4
Legal	1.4	2.0	2.6	3.1	3.0
Printing	0.3	0.4	0.6	0.6	0.7
Other*	0.5	0.7	1.7	1.0	2.7
Underwriting	4.3	10.3	20.5	35.6	61.4
<b>Total Avg IPO cost</b>	<b>7.3</b>	<b>14.4</b>	<b>27.0</b>	<b>41.4</b>	<b>70.3</b>

\*Other costs include costs like SEC registration, market listing fees and other miscellaneous costs

Costs were taken from SEC filings for US IPOs on major exchanges from January 2015 – September 2017. We have excluded IPOs that were best efforts, under \$25 million, special purpose acquisition companies (SPACs), dual listings or domestic market uplistings. We have also excluded Health Services IPOs due to sample size. Total IPOs reviewed: 315

<sup>1</sup> PWC

# Issues to Consider in Advance of IPO Kick-off Meeting

- Upgrade internal controls, including Sarbanes-Oxley compliance, to ensure integrity of financial statements and sound corporate governance
  - GAAP compliant
  - Critical accounting policies
- Preparation of due diligence materials, including capitalization table review
- Prepare fact book to support market data
- Consider whether IT systems sufficient for a public company

# Issues to Consider in Advance of IPO Kick-off Meeting

- Independent external PCAOB-registered auditor
  - Conduct necessary audits of prior-year financial statements
- Repayment of officer and/or director loans
- Sufficiency of minute books and other corporate records
- Appropriate risk management and mitigation plans

# Issues to Consider in Advance of IPO Kick-off Meeting

- Directors and officers' insurance and understand required IPO upgrades
- Selection of independent directors for Board of Directors
- Consider any required upgrades to management team
- Review compensation programs and past equity awards - SEC rules require detailed disclosure and analysis of compensation programs

# IPO Working Group

- Management, including financial reporting team
- Company counsel
- Investor relations
- Managing underwriters
- Underwriters' counsel
- Auditors
- Transfer agent
- Financial printer

# Issues to Consider in Choosing Managing Underwriters

- Firm's knowledge of, and expertise in, your industry
  - Recent transactions
  - Aftermarket performance
- Resource commitment (during and after the transaction)
  - Investment banking team – experience with similar companies
  - Research analyst
  - Distribution Capabilities – institutional versus retail
  - Market making activities

# Issues to Consider in Choosing Managing Underwriters

- Research positioning in your industry
  - Research analyst's reputation
  - Current coverage universe
- Valuation, structure and timing
  - Approach to valuation
  - Transaction terms (see "Structure of Offering" below)
  - Filing strategy/pricing strategy
  - Recommendation on timing

# Issues to Consider in Choosing Managing Underwriters

- Proposed spread and other underwriters' compensation matters
- Recommended selling strategy
  - Institutional vs. retail
  - Domestic vs. international
  - Road show recommendations



# Structure of Offering

- Offering size
  - Primary
  - Selling shareholders, if any
  - Over-allotment option (size and split between company and any selling shareholders)
- Consider implementation of dual class Common Stock
- Tax implications (e.g., UP-C IPO structure)
- Use of proceeds

# Structure of Offering

- Syndicate strategy
- Shares to be reserved for specific investors or syndicate members
- Underwriter compensation – anticipated discount from price to public
- Road show
- Nasdaq/New York Stock Exchange listing
- Ticker Symbol preference (reserve in advance)
- Directed Share Program
- JOBS Act – Review Emerging Growth Company disclosure options and determine disclosure regime

# Corporate Structure Issues

## Directors

- Composition of board after offering - a majority of independent directors are required, best to ensure compliance by IPO effectiveness
- Diversity considerations
- Board committees, including audit and compensation committees with at least 3 independent directors within one year after IPO, best to ensure compliance by IPO effectiveness
- Analyze impact if controlled company
- Director compensation arrangements
  - Cash compensation
  - Equity compensation
  - Committee compensation
- Audit Committee financial expert

# Corporate Structure Issues

## Employees

- Non-compete arrangements, non-solicitation and confidentiality arrangements
- Incentive arrangements and plans

## Directors and officers' liability insurance

- Coverage amount
- Entity coverage
- Cost
- Breadth of coverage
- Deductibles

# Corporate Structure Issues

## Corporate structure

- Charter and bylaws - review and make any necessary changes
  - Review capital structure (make sure that there will be sufficient common stock and blank check preferred, high-vote/low-vote classes of stock)
  - Antitakeover provisions, such as consideration of a classified board, frequency of director elections, blank check preferred and poison pill
  - Consider other shareholder issues, such as special meeting, written consent, exclusive forum provisions
  - Remove any unnecessary provisions
  - Review indemnification provisions

# Corporate Structure Issues

## Corporate structure

- Review corporate structure
  - Consider merging subsidiaries prior to offering
  - Tax issues
- Corporate records
  - Review minute books for completeness and accuracy

# Corporate Structure Issues

## Corporate Structure

- Share capital
  - Review existing shareholder list
  - Registration rights/waivers
  - Lock-ups
    - i. Existing lock-ups required by financing agreements
    - ii. Requests for new lock-ups
    - iii. Lock-ups in option agreements

# Corporate Structure Issues

## Corporate Structure

- Share Capital
  - Preemptive rights; antidilution provisions
  - Accuracy and completeness of stock books
  - Possible bank change-in-control issues (large shareholders)
  - Identify all issuances of compensatory equity since formation and confirm Rule 701 compliance
  - Shares authorized and outstanding - amend charter as necessary
  - Transition stock recordkeeping to transfer agent
  - Stock options outstanding and equity awards to be granted



# Corporate Structure Issues

## Corporate Governance

- Prepare new Board Committee charters (should be adopted pre-IPO to ensure compliance with applicable listing and SEC rules and regulations)
- Prepare Code of Conduct, including Code of Ethics
- Prepare Insider Trading Policy
- Prepare/consider Whistleblower Policy, Related Party Transactions Policy, Regulation FD Compliance Program, Clawback Policy, Anti-Corruption Policy
- Prepare D&O Questionnaire Form
- Stock ownership guidelines and requirements (if any) for directors and executives

# Review and Resolve Legal Issues

- Outstanding claims – resolve if practical to do so
- Third-party consents
- Disclosure issues
  - Confidentiality agreement restrictions
  - Material contracts
    - i. Identify
    - ii. Disclosure issues
    - iii. Exhibits to registration statement
    - iv. Confidential treatment (consider redactions)

# Review and Resolve Legal Issues

- Disclosure issues
  - Related party transactions
    - i. Identify
    - ii. Consider if advantageous to continue
    - iii. Consider need for new related party agreements
    - iv. Ratification by independent directors
  - Status of IP and any infringement issues
  - Employment agreements
  - Management compensation

# Review and Resolve Legal Issues

- D&O Questionnaires - Identify any issues raised by responses
- Make sure that there is appropriate trademark protection for the Company's name and that there are no other intellectual property conflicts
- Regularly review website for "gun jumping" issues
- Establish history of ordinary course business and financial communications
- Blue sky matters – most likely not an issue
- Review FINRA affiliations, if any

# Accounting and Financial Issues

- Preparation and audit of financial statements – for an emerging growth company only two years is required – however, discuss marketing needs with underwriters
- Need for unaudited interim financial statements - SAS review by auditors
- Historical option pricing or other cheap stock issues – 12-month look back; transition to 6-month (or more frequent) 409A valuations
- Historical revenue recognition policy
- Management's Discussion and Analysis of Financial Condition and Results of Operation

# Accounting and Financial Issues

- Comfort letter from auditors to underwriters
- Management letters
- Availability and discussion of forecast information
- Pro forma presentations
- Risk factor disclosure

# Interaction with Public During Offering Process; Publicity

- Prior to filing; registration period; post effectiveness
- Filing press release - Rules 135, 134
- Employee communications
- Web page communications
- Analyst and investor meetings
- Public relations firm
- Communications with existing investors

# Post-Offering Issues for Underwriters

- Continuing market making
- Provision of research reports
- Follow-on offering
- M&A Services



# Post-Offering – Beneficial Ownership Reporting Obligations

- Section 16 Reporting:
  - Section 16 “Insiders” (i.e., officers, directors, and 10% holders) must disclose, initially, their securities ownership and, on an ongoing basis, each change in ownership
  - Most of these reports are due within two business days of the reportable transaction
  - Based on complex concept of “beneficial ownership”
- Schedule 13D and Schedule 13G Reporting:
  - Persons, or members of a group, must file Section 13 reports after acquiring beneficial ownership of more than 5% of a class of equity securities of an SEC-reporting company

# Bryan Keighery



## Partner

Boston, MA

+1.617.341.7269

[bryan.keighery@morganlewis.com](mailto:bryan.keighery@morganlewis.com)

Bryan S. Keighery represents life science and technology companies in a range of corporate and securities transactions. He handles a variety of corporate finance transactions for public companies, including initial public offerings, follow-on offerings, registered direct offerings (RDOs), and private investments in public equity (PIPEs), as well as venture capital and other financing transactions for privately held companies. Additionally, Bryan counsels both public and privately held companies on general corporate law, mergers and acquisitions, and other business matters.

Bryan also regularly counsels public companies in annual, quarterly, and periodic reports; proxy statements and SEC compliance under US federal securities laws; and corporate governance requirements of various stock exchanges, including NYSE and Nasdaq.

# Alexandra Good



## **Associate**

Pittsburgh, PA

+1.412.560.7450

[alexandra.good@morganlewis.com](mailto:alexandra.good@morganlewis.com)

Alexandra (Ali) Good counsels public companies and their boards of directors on matters relating to corporate governance and securities regulation. She specializes in advising clients on annual meeting and proxy-related issues, periodic reporting and disclosure requirements, Nasdaq and NYSE compliance, shareholder engagement, environmental, social, and governance (ESG), and executive compensation matters. Ali also has experience with public capital raising transactions and business combinations, including providing counsel to special purpose acquisition companies (SPACs) and target companies in “de-SPAC” transactions.

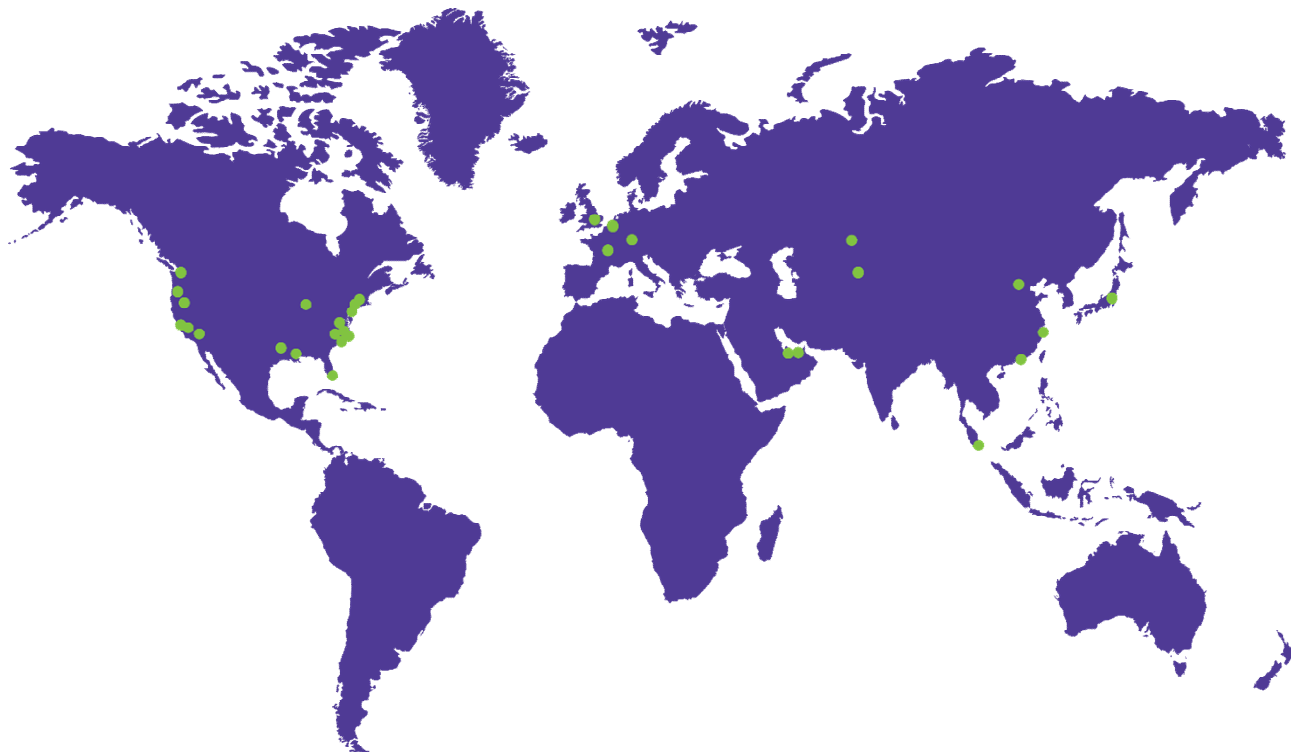
Ali is committed to keeping companies and their boards of directors up to date on the latest governance and disclosure issues and trends. In addition to regularly writing LawFlashes, she participates in the Morgan Lewis Public Company Academy by presenting on recent developments and hot topics.

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