An emerging growth company or “EGC” is defined under the JOBS Act as an issuer (including a foreign private issuer) with total annual gross revenues of less than $1 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year.

An EGC may confidentially submit a draft registration statement for an IPO for non-public review, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 15 days prior to the issuer’s commencement of a road show.
• An EGC can engage in “test the waters” communications. Testing the waters with institutional accredited investors and QIBs provides valuable information about the presentation of the company’s business, the valuation that institutional investors would ascribe to the offering, and their interest in the offering. All of this will inform the company’s and the underwriters’ views.

• The vast majority of EGCs that priced an IPO since the JOBS Act took effect (over 90%) have confidentially submitted at least one draft registration statement prior to publicly filing and the majority of EGCs have submitted at least two draft registration statements prior to making their first public filing.
• Taking advantage of the scaled financial disclosures has gained some market acceptance, with less than half of all EGCs electing to provide only two years of audited financial statements rather than three years.

• EGCs are not required to comply with new or revised GAAP accounting pronouncements until those pronouncements apply to private companies, however, the majority of EGCs have not taken advantage of this extended transition period for compliance with new or revised GAAP accounting pronouncements.
• The vast majority of EGC IPO issuers in 2014 and 2015 that otherwise would have been required to include traditional executive compensation disclosures elected to take advantage of the reduced disclosure, with many omitting the CD&A section and including only a Summary Compensation Table and Outstanding Equity Awards Table covering three rather than five named executive officers and limiting the tabular disclosures to two years.

• Almost all EGCs have indicated that they intend to take advantage of (or reserve the right to do so in the future) the exemption from providing the auditor attestation report under Sarbanes-Oxley Act Section 404(b).
Making use of the JOBS Act, cont’d.

- **Submit Draft S-1**: An EGC may remain in the confidential review process until required to file Form S-1, with the SEC issuing comments and the EGC responding with draft submissions.

- **File S-1**: The SEC must review the draft registration statement on a confidential basis.

- **Road show**: An EGC or any other person authorized by the EGC can “test the waters” in communications with QIBs and institutional accredited investors before or during the IPO.

- **S-1 Effective**: Broker-dealers, including those participating in the IPO, can publish research before, during or after the IPO without the research being deemed an “offer” under the Securities Act.

After filing the Form S-1, the process is the same as a pre-JOBS Act IPO.
## Dual class capital structures

### Summary
- Recap company's common stock into two classes of common – existing shareholders get high-vote stock and low-vote stock is sold in the IPO and thereafter.
- Maintains control in a founder, family or small group regardless of dilution created by further stock issuances (for acquisitions or otherwise).
- Charters typically provide that high-vote shares lose high-voting rights if transferred and receive same consideration in a merger as low-vote shares.

### Advantages
- Well-established structure.
- Allows for continued focus on core values and objectives.
- Particularly useful where founders have long-term vision for the company that creates value; less distraction by short-term considerations such as quarterly earnings, takeover offers and activist investors.

### Disadvantages
- May be disfavored by some institutional shareholders (although empirical evidence is unclear whether companies with dual class structures tend to underperform their peers).
- Decisions by control group are subject to “entire fairness” review unless special committee and minority approval are employed.
- IPO pricing may be discounted for risk inherent in low-vote shares.
- Diminished liquidity may lead to greater stock price volatility.
Dual class capital structures.

- 85% Single class of common stock
- 14% Dual class of common stock
- 1% Two classes of common stock
A “controlled company” is a company of which more than 50% of the voting power for the election of directors is held by an individual, a group, or another company. The calculation of voting power held by a group can include shares covered under voting agreements between or among shareholders relating to the election of directors.

A company elects to be controlled company in its initial listing application to an exchange and discloses in its filings that it relies on certain exemptions. A “controlled company” is not required to comply with the following exchange requirements:

- A company’s board of directors is required to have a majority of independent directors.
- Independent directors must determine the compensation of the CEO and other executive officers.
- Independent directors must select or recommend nominees for directors.
Frequency of Controlled Companies.

- Controlled Company: 17%
- Non-Controlled Company: 83%

Dual class capital structures, cont’d.
Offerings to an IPO issuer’s customers is not a new phenomenon but it seems to have renewed interest. Boston Beer (a/k/a Sam Adams) was one of the first IPO issuers to undertake an offering of shares in its IPO to its beer consumers. Since late 2013, at least 18 companies, including four billion-dollar-valued startups, have included consumer offerings in their IPOs. Rationale for direct-to-consumer offerings:

- Customers gain a sense of ownership in the companies they support.
- Companies demonstrate gratitude and appreciation for continued support.
- Expands the IPO investor pool beyond large funds and wealthy brokerage clients.
- Increases shareholder retention; investors less likely to sell shortly after IPO.
You can undertake a consumer offering as part of your IPO. You can do this seamlessly by using a retail broker or a specialty firm, like Loyal3. Since its inception in 2013, Loyal3 has participated in 15 IPOs, facilitating the sale of equity to 54,000+ participants and raising $205M for issuers, including:
Examples

• Sample free writing prospectuses (FWPs) inviting consumers to participate in the IPO.
  • **Square, Inc.** (11/9/15):
    https://www.sec.gov/Archives/edgar/data/1512673/000119312515371912/d68668dfwp.htm
  • **Blue Buffalo Pet Products** (7/8/15):
    https://www.sec.gov/Archives/edgar/data/1609989/000119312515248081/d13593dfwp.htm
  • **Virgin America** (11/3/14):
    https://www.sec.gov/Archives/edgar/data/1614436/000119312514393025/d814828dfwp.htm
• **Dave & Buster’s (9/29/14):**
  https://www.sec.gov/Archives/edgar/data/1525769/000119312514357385/d735753dfwp.htm

• **AMC Entertainment Holdings (12/3/13):**
  https://www.sec.gov/Archives/edgar/data/1411579/000110465913088187/a13-18601_12fwp.htm
A funny thing happened on the way to the IPO...

...a merger, an acquisition, or a late-stage private placement
• Perhaps given the uncertain market conditions, and perhaps in part due to the view that an IPO is no longer as attractive, many more US IPO candidates are pursuing dual track processes.
• In a recent study, Bloomberg reports that 14 out of 52 companies (27%) withdrew their IPO registration statements in 2016 and were acquired within six months of doing so. This compares to approximately 14% in 2015. These numbers are understated given that many more IPO candidates abandon the IPO process before they file publicly with the SEC.
• This trend is more pronounced if you consider the VC- and PE-backed IPO candidates who appear more amenable to an M&A exit.
• However, few unicorns are being acquired.
The below table provides some data:

<table>
<thead>
<tr>
<th>Number of U.S. IPOs Withdrawn in 2015 and 2016</th>
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</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td><strong>2015</strong></td>
</tr>
<tr>
<td>Withdrawn not Sold: 68</td>
</tr>
<tr>
<td>Withdrawn and Sold: 11</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>2016</strong></td>
</tr>
<tr>
<td>Withdrawn not Sold: 38</td>
</tr>
<tr>
<td>Withdrawn and Sold: 14</td>
</tr>
</tbody>
</table>

Source: Bloomberg Law as of Nov. 1, 2016
Data is for companies that announced a sale or partial sale within six months of withdrawing their U.S. IPO registration statements.
Dual track process

Advantages and Disadvantages

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
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<tbody>
<tr>
<td><strong>Better pricing.</strong> Pursuing both paths (i) creates price tension that could produce a more robust competitive process and (ii) insures maximum exposure and uncovers prospective buyers; 22% to 26% premium over companies acquired without a concurrent IPO (James C. Brau, Ninon K. Sutton &amp; Nile W. Hatch, Dual-track versus single-track sell-outs: An empirical analysis of competing harvest strategies, 25 Journal of Business Venturing 389-402 (2010))</td>
<td><strong>Public Disclosure.</strong> Unless the issuer can avail itself of the JOBS Act, public filing of registration statement may result in undesirable public disclosures; amount and type of information required to be disclosed in IPO registration statement frequently includes information that management would rather not hand over to regulators, competitors, customers and the general public in the absence of an IPO</td>
</tr>
<tr>
<td><strong>Less dependence on market conditions and greater flexibility.</strong> Dual track allows seller to keep its options open until it becomes clear which route will yield the highest value, thus preserving flexibility and hedging against deal uncertainty and market volatility (e.g., M&amp;A process can provide a valuable backstop in the event that markets turn against seller during the relatively lengthy IPO process)</td>
<td><strong>Adverse effect on efficiency of outcome.</strong> May be perceived as lack of strategic direction or limited acquisition interest, which may lead key participants to misread market signals, negatively impacting final result (e.g., potential buyers in sale process might determine that IPO process is more likely route and elect not to spend time and money necessary to pursue acquisition)</td>
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<tr>
<td><strong>Creates leverage for sale process.</strong> IPO creates a credible alternative which increases the leverage of the seller in its M&amp;A negotiation (particularly important when there is a limited set of suitors); prospective purchasers in the sale process will be incentivized to bid higher than each other but also to provide an attractive alternative to an IPO value</td>
<td><strong>Diversion of management resources.</strong> Each process on its own creates significant distractions; attempting to orchestrate both an IPO and a sale process at the same time will limit the amount of time and attention that management can spend running the business. However, (i) diversion can be reduced by leveraging similarity of many required processes (e.g., detailed forecasting and gathering diligence materials) and (ii) dual-track approach is far less disruptive for management than a series of unsuccessful sales attempts</td>
</tr>
<tr>
<td><strong>Creates higher degree of urgency.</strong> Prospective buyers (i) may be more inclined to act in the face of a credible possibility of an IPO and (ii) will be encouraged to close their bid on a timeline dictated by seller prior to any hard deadlines in the IPO process</td>
<td><strong>Market risk exposure.</strong> A failed IPO attempt could harm the company’s reputation and potentially the value of its business and assets; JOBS Act confidential submission, if applicable, could alleviate this concern</td>
</tr>
<tr>
<td><strong>Complementary strategies.</strong> Legal and process requirements of an IPO can assist, and be complementary to, the M&amp;A process - e.g. (i) IPO data room can be used, with minimum additional work, as a sale process data room; and (ii) if the company ends up being sold to a buyer who requires financing, the IPO registration statement offers a significant head start on a debt offering memorandum</td>
<td><strong>Substantial additional costs.</strong> Running two significant and complicated work streams in tandem, especially where the IPO track is pursued for several rounds of SEC comments or to completion, is likely to involve substantial costs. However, the dual-track costs are significantly lower when compared to costs that would result from a failed single-track exit transaction followed by later effort to obtain liquidity</td>
</tr>
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### Timing and Structure

Timeline and structure of dual-track process often depend on which option is more promising.

<table>
<thead>
<tr>
<th>IPO is the more promising exit</th>
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<tbody>
<tr>
<td>• File or submit the registration statement with the SEC and work through one or more rounds of SEC comments before starting the M&amp;A process; more flexibility presented by JOBS Act confidential submission process</td>
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<tr>
<td>• M&amp;A process can be used as backstop of IPO exit if IPO exit doesn’t live up to expectations, or can result from inbound interest</td>
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<table>
<thead>
<tr>
<th>Neither track is more promising</th>
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<tbody>
<tr>
<td>• File or submit the registration statement with the SEC at about the same time as initiating M&amp;A sale process</td>
</tr>
<tr>
<td>• “Classic” dual-track process; contemplates filing of IPO registration statement and simultaneous commencement of solicitation of interest from potential buyers</td>
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<tr>
<th>M&amp;A sale is the more promising exit</th>
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<tbody>
<tr>
<td>• Start M&amp;A auction process and delay the filing of a registration statement for as long as possible, but prepare a complete and ready-to-file registration statement; more flexibility presented by JOBS Act confidential submission process</td>
</tr>
<tr>
<td>• Existence of the registration statement is used to inform potential buyers that company has a credible alternative and drive potential bids higher; registration statement may never be filed with SEC</td>
</tr>
</tbody>
</table>
Other Timing Issues

Management of timeline of dual-track process is of paramount importance; if timeline for the IPO and M&A process are not coordinated, company may be forced to make a decision in connection with one process that has unintended negative consequences – For example:

- If after the end of SEC review process for the IPO (when the company is almost ready to launch its road show), the offering is postponed to continue acquisition discussions, favorable market conditions may disappear.
- Delay caused by ongoing acquisition discussions can result in need to update company’s IPO registration statement with more recent financial statements.
Time to choose between the two tracks

- The choice can be delayed until after the IPO road show to immediately before signing underwriting agreement.
- However, in practice, the choice is usually made before start of IPO road show (because of significant cost of running a road show). If an attractive acquisition offer does not seem imminent, the sale process is ordinarily shut down when the road show begins.
Other Considerations

Confidentiality

- Confidentiality of information disclosed in the sale process is absolutely crucial if the IPO process is not to be compromised
  - Particular attention should be paid to putting in place and enforcing comprehensive confidentiality agreements with prospective buyers.
  - A limited auction/sale process to a select few prospective purchasers is well suited to a dual-track process.
- Advisable to include a standard public company standstill provision in the confidentiality agreements
Highly undesirable for a former potential buyer to make a hostile offer for the company during the period immediately following its IPO.

Sidesteps making a determination as to whether prospective buyers will be restricted from trading in the company’s securities following the IPO by virtue of being in possession of inside information.

**Complying with securities laws communication restrictions**

- Although an IPO registration statement filed by a domestic U.S. company will be publicly available on the SEC’s website and can (and invariably will) be viewed by any potential buyer, there are limitations on the ability to use the registration statement prior to the effective date.
Other disclosure issues

• Absent a leak, the sale process usually does not need to be publicly disclosed prior to an acquisition announcement, but disclosure may be required in certain circumstances (e.g., if an acquisition deal is reached and then falls apart, company must consider whether the reasons for the busted deal must be disclosed in the registration statement).

M&A sale terms

• If an acceptable acquisition offer emerges from a dual-track process, company (i) may seek to style the definitive agreement as if the transaction were a “public-public” merger, with limited representations and no indemnities or escrows following the closing, or (ii) may try to make the disclosure in IPO registration statement an exception to representations and warranties in a private sale agreement, permitting company to prepare shorter disclosure schedules.
Unwinding the IPO Registration

• Assuming an acquisition agreement is signed after the IPO registration statement has been filed, the registration statement will need to be withdrawn prior to closing the sale. However, it is usually advisable to keep the IPO registration statement and the exchange listing application on file until shortly before the closing to mitigate disruption if the M&A deal doesn’t close.

Valuation impact

• A dual track can create tricky valuation issues, if seller pursues an IPO after receiving one or more acquisition offers
  • Company must consider the impact of acquisition offers on its subsequent determinations of fair market value for option grants made prior to the IPO.
  • Company will need to evaluate whether the amount of any acquisition offers should—or must—be disclosed in response to “cheap stock” comments from the SEC.
In evaluating alternatives, it is often helpful to consider each of the company’s objectives and assess which alternative best meets each stated objective.

- **IPO:** Allows you to raise an unlimited amount
- **4(a)(2)/Rule 506:** Allows you to raise an unlimited amount

**Raise capital**

- **IPO:** Institutional investors will seek out opportunities in IPOs
- **4(a)(2)/Rule 506:** Institutional investors may be interested in a late-stage (mezzanine or “pre-IPO”) round; generally investments will be limited to accredited investors

**Attract institutional investors**
Raise awareness for the company

- **IPO**: Probably most effective in raising awareness
- **4(a)(2)/Rule 506**: Generally no public marketing (but for a handful of Rule 506(c) deals)

Perception

- **IPO**: Despite the trend toward staying private longer, when seeking a liquid public market, an IPO is still the gold standard
- **4(a)(2)/Rule 506**: The market now expects for successful pre-IPO companies to undertake a late-stage private placement in the months prior to the IPO
Create a liquid trading market

Offer an investment opportunity to your customers

- **IPO**: Generally the underwriters will make a market in the stock; equity analyst coverage is essential
- **4(a)(2)/Rule 506**: Limited liquidity; may need to provide registration rights

- **IPO**: Your customers may participate; we provide examples of “consumer” offerings
- **4(a)(2)/Rule 506**: Offers would necessarily be limited to accredited investors
Evaluating the alternatives, cont’d.

- **IPO**: Post-IPO, the company would have a valuable currency to use in connection with acquisitions.
- **4(a)(2)/Rule 506**: A resale registration statement or other approach to liquidity would be required.

Provide an acquisition currency

- **IPO**: Post-IPO, the company will be able to undertake subsequent public or private financings.
- **4(a)(2)/Rule 506**: Company may undertake multiple exempt offerings.

Impact on future financings