

Issues to Consider in Preparing for an IPO

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OUTLINE OF ISSUES TO CONSIDER IN PREPARING FOR AN IPO

Advanced planning is critical for an emerging company contemplating an initial public offering (IPO). With market forces narrowing available “windows” to go public, an issuer that is well-prepared should be able to launch and complete its IPO when the timing is right. This outline provides an overview of many of the issues that will need to be considered addressed.

A. Initial Considerations and Necessary “Building Blocks”

1. Consider each “pro” (improved financial position/access to equity capital at public company valuation/stockholder liquidity/enhanced profile) and every “con” (costs/ongoing legal requirements/loss of confidentiality/influence of independent directors/additional finance and accounting personnel) of going public.
2. What is the regulatory nature of the issuer?
 - (a) Emerging growth company (JOBS Act)
 - (b) Smaller reporting company
 - (c) Foreign private issuer
3. Are all the basic building blocks present:
 - (a) audited financial statements
 - (i) GAAP compliant
 - (ii) critical accounting policies
 - (iii) books and records procedures are in place
 - (iv) understanding of internal controls
 - (b) independent external auditor
 - (c) stable management team, pre and post-IPO
 - (d) appropriate capital/tax/organizational structures
 - (e) implement corporate governance structure that can evolve to be public company compliant
4. Confirm that a “clear story” and market positioning for the Company and its IPO exists and is agreed upon by all members of management and the Board
5. Preparedness for due diligence
 - (a) All material contracts (including any financial covenant, demand registration and other rights) are identified, complete and organized
 - (b) All regulatory and intellectual property filing histories well organized
 - (c) Financial information and underlying data is gathered and organized
 - (d) All material legal matters identified
 - (e) 5 year look back common

B. Measures to Consider in Advance of Organizational Meeting

1. Prepare and review list of candidates for the post-IPO board of directors:
 - (a) Independence issues
 - (b) Pre-IPO investor board members
 - (c) Public company D&O insurance/indemnification requirements
 - (d) D&O Questionnaire
2. Identify ideal shareholder base (long-term, institutional shareholders)
3. Review key intellectual property assets
 - (a) Obtain license to use any key IP that is not owned

- (b) Consider freedom to operate patent legal opinion
- (c) Consider public company corporate name and further protecting “brand” by registering logos and any frequently used slogans
- 4. Establish Web site and public communications policy
 - (a) Update web site sufficiently in advance of IPO so as to establish a history of ordinary course business and financial communications
 - (b) Limit web site and other public communications to ordinary course business and financial matters
 - (c) Make sure website is in sync with proposed Company marketing position
 - (d) Legal review of website including legends
- 5. Review and be able to clearly articulate regulatory pathway and reimbursement strategy
- 6. Establish rational fair market value exercise price for option grants to avoid “cheap stock” issues resulting in compensation expense – appraisal every 6 months instead of annually
- 7. Preferred Trading Market (NASDAQ vs. NYSE)
- 8. Identify necessary/desired corporate governance structures:
 - (a) Stock exchange and SEC requirements
 - (i) Corporate governance guidelines
 - (ii) Committee charters
 - (iii) Code of business conduct and ethics
 - (iv) Related party transactions
 - (v) Compliance program
 - (i) Insider trading other SEC reporting and disclosure requirements
 - (ii) FDA and other regulatory compliance issues
 - (b) Board and committee structure and composition
 - (c) Risk management
- 9. Confirm that all pre-IPO agreements allow the IPO or address any limitations
- 10. Estate Planning. Senior management may desire to consider exercising some vested options in 2014 and gifting shares to children/trust at lower private company value for gift tax purposes and starting 1 year holding period for capital gains purposes or forming a GRAT

C. Form Working Group

- 1. Management team responsible for IPO, SEC disclosure document (legal and accounting), stock exchange listing and documentation of corporate governance determinations
 - (a) CEO/CFO
 - (b) Financial reporting team
 - (c) Internal legal counsel
 - (d) Investor relations function
- 2. Company outside counsel
 - (a) Drafts documents – consider having legal counsel prepare draft of “back of the back” in advance of Org meeting
 - (b) Assists management team with drafting of Company and business description sections

3. Managing underwriters
4. Underwriters' counsel
5. Auditors
6. Transfer agent, negotiate fees for necessary services (including whether it or company will maintain official stockholder lists)
7. Financial printer, negotiate fees for services
8. Electronic data room provider, if not financial printer

D. Specific Underwriter Issues

1. Firm's expertise in life sciences industry segment and client base
 - (a) Recent transactions
 - (b) Aftermarket performance
 - (c) Ability to fill book and sell IPO to long-term/institutional stockholders
 - (d) Over-allotment option experience
2. Resource commitment (during and after the transaction)
 - (a) Post-IPO analyst coverage
 - (b) Investment banking team
 - (c) Market making activities
3. Determine positioning in life sciences industry segment
 - (a) Current coverage universe
 - (b) Firm's ability to assist management in articulating the Company's opportunity
 - (c) Firm's positioning of Company, such as a biotechnology company versus speciality pharma company
4. Valuation, structure and timing
 - (a) Approach to valuation
 - (b) Transaction terms (see "Structure of Offering" below)
 - (c) Filing strategy/pricing strategy
 - (d) Recommendation on and ability to meet timing demands
5. Proposed spread and other underwriters' compensation matters
6. Recommended selling strategy
 - (a) Institutional vs. retail
 - (b) Domestic vs. international
 - (c) Road show recommendations
7. Specific qualifications as a manager
 - (a) Differentiation from other investment banking firms
 - (b) Value-added capabilities
8. Lead-managers
 - (a) Number of lead managers
 - (b) Fee split arrangement
 - (c) co-managers and key syndicate members
9. Any recommended changes in Company's management team or corporate strategy?
10. Any shares to be reserved for existing investors and/or existing investor IPO purchase commitment requirements?

E. Time and Responsibilities for Offering (12-15 week process)

The T&R schedule for an IPO will depend on (i) the Company's preparedness, (ii) whether any auditing/accounting/legal issues arise that can delay the schedule, (iii) market factors and (iv) the SEC comment process. Assuming a company has the necessary building blocks in place, the following schedule may work (assumes average 14 week process):

1. Introductory Meeting of – Week 1
2. Drafting meetings – Weeks 1 – 4
3. Due diligence – Weeks 1 – 4
4. Employee meeting – management should meet with employees to inform them of the planned IPO and discuss confidentiality/gun jumping and other relevant issues (such as what the IPO means for them)
5. Form S-1 filing target date – End of Week 4
6. FINRA review (whether underwriter compensation is “reasonable”)
7. Stock exchange listing application/reserve trading symbol
8. SEC review period
 - 30-35 days to first comments – End of Week 9
 - 15 days to complete response – End of Week 11
6. Prepare management for roadshow
 - mock investor meeting sessions
 - pre-roadshow review of roadshow materials
9. IR/Underwriter development of road show schedule/presentation – Weeks 12-13
10. Stockholders' meeting (see “Corporate Structure Issues” below)
11. Other lead time issues (art work for prospectus, requests for confidential treatment, etc.)
12. Stock exchange promotion (ringing opening bell, etc.)
13. Pricing and Closing – Week 14

F. Review Corporate Structure Issues

1. Board of directors; management; employees
 - (a) Directors
 - (i) Composition of board after offering – at least 3 independent directors are required (a VC designee may be independent)
 - (ii) Board committees and responsibilities, including an audit committee with at least 3 independent directors and a compensation committee consisting of at least 2 independent directors. (NASDAQ and NYSE requirements)
 - (iii) Director compensation arrangements
 - (b) Executive officers
 - (i) Titles
 - (ii) Section 16 insiders - reporting and compliance issues
 - (iii) Employment and non-compete agreements
 - (iv) Incentive arrangements
 - (c) Employees
 - (i) Non-compete arrangements

- (ii) Incentive arrangements
 - (d) Option and benefit plans
 - (i) Compliance with ERISA, tax and securities laws - Rule 701
 - (ii) Consider plans or plan amendments – option/SAR plans, 401(k) plan (with or without company stock feature), employee stock purchase plan.
 - (iii) Registration of shares issuable upon exercise of options (Form S-8)
 - (e) Directors and officers liability insurance
- 2. Corporate structure
 - (a) Charter and bylaws - review and make any necessary changes
 - (i) Review capital structure (make sure that there will be sufficient common stock and blank check preferred)
 - (ii) Antitakeover provisions
 - (iii) Remove any unnecessary provisions
 - (iv) Review indemnification provisions
 - (b) Review corporate structure
 - (i) Consider merging subsidiaries into parent prior to offering
 - (ii) Tax issues, including the use of a Delaware “technology” subsidiary for state tax planning
 - (c) Corporate records
 - (i) Review minute books for completeness and accuracy
- 3. Share capital
 - (a) Review existing shareholder list
 - (i) Registration rights/waivers
 - (ii) Lock-ups
 - (iii) Preemptive rights; antidilution provisions
 - (iv) Accuracy and completeness of stock book
 - (b) Identify all issuances of shares since formation
 - (c) Shares authorized and outstanding - amend charter as necessary
 - (d) Transition stock recordkeeping to transfer agent

G. Review Legal Issues

- 1. Outstanding claims – resolve if practical to do so
- 2. Loan agreement restrictions or other third-party consents
- 3. Disclosure issues
 - (a) Confidentiality agreement restrictions
 - (b) Material contracts
 - (i) Identify
 - (ii) Disclosure issues
 - (iii) Exhibits to registration statement
 - (c) Related party transactions
 - (i) Identify
 - (ii) Consider if advantageous to continue
 - (iii) Review documentation
 - (iv) Ratification by independent directors
 - (d) Employment agreements
 - (e) Management compensation

- (f) Option grants to executive officers
 - (g) Pending acquisitions or other material transactions
 - (h) Restrictions on future activity contained in license agreements, service agreements and other business agreements
 - (i) Antitakeover provisions
 - (j) D&O questionnaires - Identify any issues raised by responses
4. Make sure that there is appropriate trademark protection for the Company's corporate name and product (and proposed pipeline product) names and that there are no other intellectual property conflicts
 5. Regularly review Company website for "gun jumping" issues and regulatory compliance
 6. Make sure Company can articulate reimbursement strategy even if development stage company
 7. Understand regulatory pathway to product approval, including regulatory milestones and time range to achieve them, assuming successful IPO

H. Review Accounting and Financial Disclosure Issues

1. Preparation and audit of financial statements – 3 years (2 years for emerging business but underwriters still sometimes desire to have 3 years)
2. Need for unaudited interim financial statements - SAS 71 review
3. Historical option pricing or other cheap stock issues
4. Historical review recognition policy; new revenue recognition and other accounting standards
5. Management's Discussion and Analysis of Financial Condition and Results of Operation
6. Comfort letters, as may be required by underwriters
7. Management letters
8. Availability, discussion and disclosure (yes or no) of forecast information
9. Tax issues - NOLs (Section 382 analysis)
10. Goodwill/intangibles
11. SEC requirements for separate financials in connection with acquisitions; significant equity investees, guarantors
12. Risk factor disclosure

I. Interaction with Public During Offering Process; Publicity

1. Prior to filing
2. Registration period – "test the waters" meetings
3. Post effectiveness
4. Filing press release¹ - Rules 135, 134
5. Employee communications
6. Web page communications
7. Analyst and investor meetings
8. Public relations firm (to help shape company profile)

¹ The Jumpstart Our Business Startups Act allows for a confidential SEC review procedure for IPO registration statements of emerging growth companies prior to their first registered sale of common equity.

9. Quiet period restrictions
10. Free writing prospectuses

J. Post-Offering Issues for Underwriters

1. Continuing market making
2. Provision of research reports; analyst coverage (earnings calls)

K. Post-Offering Issues for Company

1. Prepare for upcoming earnings call/next quarter SEC filing
2. Regulation FD
3. Compliance program development
 - (a) Business continuity plan
 - (b) Disclosure Committee
 - (c) Internal audit/enterprise risk management
 - (d) Internal control over financial reporting
 - (e) Preparation for SOX 404 attestation

Morgan Lewis Emerging Business and Technology Selected Team Member Card

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