An Expert's View

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Josh reviews 2015 trends in IPO activity:

How do the "JOBS Act 2.0" provisions of the recently enacted Fixing America's Surface Transportation Act (FAST Act) facilitate IPOs by EGCs?

Signed into law on December 4, 2015, the FAST Act builds on the JOBS Act to further enhance EGC access to the IPO market by:

- Reducing the number of days before a roadshow that an EGC must publicly file its registration statement with the SEC from 21 days to 15 days.
- Establishing a grace period for companies that lose their EGC status during the IPO process. If a company was an EGC at the time that its registration statement was first submitted to the SEC for review (whether through confidential submission or public filing), but later ceases to be an EGC, it will still be treated as an EGC for the purposes of the IPO process through the earlier of:
  - the date it consummates its IPO; or
  - one year after it has lost its EGC status.

  While the FAST Act only expressly amends the statutory provision relating to confidential submission, we are optimistic that the SEC will permit companies that use the grace period to also continue to take advantage of the special disclosure rules for EGCs.
- Permitting an EGC that submits a registration statement (whether through confidential submission or public filing) on Forms S-1 or F-1 to omit financial information for historical periods otherwise required under Regulation S-X if:
  - the omitted financial information relates to a historical period that the issuer reasonably believes will not be required to be included in its registration statement at the time of the contemplated offering; and
  - prior to the distribution of a preliminary prospectus to investors, the registration statement is amended to include all financial information required by Regulation S-X at the time of the amendment.

The SEC's Division of Corporation Finance has issued interpretive guidance clarifying that the FAST Act:

- Permits the omission of financial information for historical periods of other entities (such as acquired businesses) if the EGC reasonably believes that such information will not be required to be presented at the time of the offering.
- Does not permit the omission of financial statements for an interim period that will be included within required financial statements for a longer interim or annual period at the time of the offering.

IPO, China Customer Relations Centers, Inc.'s $9.6 million IPO, and Oasmia Pharmaceutical AB's $9.5 million IPO) (see *Figure C*). In contrast, the underwriting discounts in 2014 were spread across a wider range, from 0.75% to 8.42%.

In 2015, 108 IPOs (70.6%) featured an underwriting discount of 7%. This benchmark discount was particularly pronounced for pharmaceutical/biotechnology IPOs, where over 90% of IPOs had a 7% discount.

One IPO featured an innovative bifurcated approach to underwriter compensation. In its $40 million IPO, Wowo Limited, an FPI and EGC, offered the underwriters a:

- 3.5% discount for sales to investors introduced by the issuer.
- 6.5% discount for sales to investors introduced by the underwriters.

CHOICE OF SECURITIES EXCHANGE

Of the 153 US IPOs in 2015, far more issuers chose to list their securities on NASDAQ (73.9%) than on the NYSE (24.2%) or NYSE MKT (2%). More specifically:

- 53 issuers (34.6%) listed on the NASDAQ Global Select Market.
- 43 issuers (28.1%) listed on the NASDAQ Global Market.
- 17 issuers (11.1%) listed on the NASDAQ Capital Market.
- 37 issuers (24.2%) listed on the NYSE.
- Three issuers (2%) listed on the NYSE MKT.

Of the 61 pharmaceutical/biotechnology companies that went public in 2015, 59 (96.7%) listed their securities on one of the NASDAQ exchanges. Similarly, of the nine retailers that went public in 2015, seven (77.8%) listed on one of the NASDAQ exchanges. Services companies, on the other hand, were split evenly between the NYSE and NASDAQ at 14 companies each.

EGCs are clearly taking advantage of the confidential submission process, with more than 90% of issuers that are EGCs filing confidentially in 2015. What trends have you seen regarding the use by EGCs of the other accommodations available to them under the JOBS Act?

In addition to taking advantage of the confidential submission process, we have also found that nearly every eligible issuer is taking advantage of the JOBS Act provisions that enable EGCs to present executive compensation disclosure for fewer executive officers (typically three instead of five) and to omit a Compensation Discussion and Analysis.

Use of other JOBS Act accommodations has proven more varied. For instance, we are seeing mixed practice regarding whether an EGC elects to present only two years of audited financial statements in its registration statement, rather than the three years required of non-EGCs. This decision seems largely driven by both the marketing preferences of the underwriters and the degree to which the information is available for a given issuer without significant incremental time and expense.

We are also seeing mixed practice regarding the use of the "testing the waters" provisions of the JOBS Act. Practice here continues to develop and evolve as market participants learn more about the utility of the testing the waters process for particular issuers and situations.

In the years since the enactment of the Sarbanes-Oxley Act of 2002 (SOX), the average size of IPO issuers in the US by revenue and earnings has generally been increasing. Do you expect the JOBS Act to change this trend?

The "IPO on ramp" provisions of the JOBS Act and the FAST Act have reduced, to a degree, the burden of the IPO process on companies. However, we do not expect this legislation to reverse the decline in the number of smaller companies going public.

Despite the recent changes to the IPO process for EGCs, the ongoing costs of being a public company in the US have risen over time, increasing the requisite scale a company must have to effectively bear these costs. Apart from the "one-time" costs associated with the IPO process itself, the incremental financial and other resources required to operate as a public company, including compliance with SOX, are significant.

Companies that choose to go public also become subject to public policy driven regulations with little connection to investor protection or efficient capital markets, such as recently adopted disclosure regimes pertaining to the use of conflict minerals, resource extraction, activities involving Iran, and CEO pay ratios. More prescriptive (and proscriptive) governance requirements, and increased levels of shareholder activism, may also diminish the appeal of life as a public company to certain private company owners and managers.

Conversely, the JOBS Act has made it more attractive for private companies to remain so by increasing the number of shareholders that a private company may have before it is required to register with the SEC and providing an exclusion from this cap for shareholders who received their securities under an employee compensation plan. We have also seen that, at least in certain sectors, private companies are able to fund themselves at attractive valuations without having to go public.

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Search Selecting a US Securities Exchange for a discussion of the quantitative and qualitative listing requirements for the NYSE and NASDAQ and descriptions of other US securities exchanges.

Search Comparative Corporate Governance Standards Chart: NYSE vs. NASDAQ for a comparison of the corporate governance listing requirements of the NYSE and NASDAQ.

ACTIVE INDUSTRY SECTORS

In 2015, the services and pharmaceutical/biotechnology industries dominated the IPO markets in terms of the total number of IPOs (28 and 61, respectively). Offerings by these types of companies represented 58.2% of all IPOs and raised a total of over $12.9 billion (53.9% of the proceeds raised in all IPOs). The largest services company IPO was by First Data Corporation for $2.6 billion, which was also the largest IPO of 2015. The largest pharmaceutical/biotechnology company IPO was by Axovant Sciences Ltd. for $315 million.

The services industry also achieved the highest average deal value in the first two quarters, with average proceeds of more than $280.9 million per IPO. The pharmaceutical/biotechnology industry, by contrast, averaged just $82.8 million per IPO, while the retail industry averaged $139.1 million per IPO. The average deal value for all industry sectors was $156.6 million.

The retail industry represented 5.9% of all completed IPOs, raising a total of over $1.2 billion (5.2% of the proceeds raised in all IPOs). High-profile IPOs completed by retailers included offerings by:

- Party City Holdco Inc. for $371.9 million.
- Shake Shack Inc. for $105 million.