

MEMORANDUM

TO: Advance Public Comment File on Regulatory Initiatives under Title IV of the JOBS Act – Small Company Capital Formation

FROM: Zachary Fallon
Special Counsel
Office of Small Business Policy
Division of Corporation Finance
U.S. Securities and Exchange Commission

RE: Meeting with William R. Hambrecht of WR Hambrecht + Co and Attorneys from Morrison & Foerster LLP

DATE: December 11, 2012

On December 3, 2012, Commission staff met with William R. Hambrecht of WR Hambrecht + Co and James R. Tanenbaum, David M. Lynn, and Anna T. Pinedo, attorneys from Morrison & Foerster LLP to discuss issues regarding the implementation of Title IV of the Jumpstart Our Business Startups Act.

The following Commission staff were present: Lona Nallengara, Mauri Osheroff, Gerald Laporte, Karen Wiedemann, Jennifer Zepralka, and Zachary Fallon from the Division of Corporation Finance; and Kathleen Hanley, Scott Bauguess, Vladimir Ivanov, Ioannis Floros, and Joshua White from the Division of Risk, Strategy and Financial Innovation.

The slide presentation distributed to Commission staff during the meeting is attached.

Attachment

Title IV Rulemaking

December 2012

Overview

The Death of the Small IPO

- Changing economics of the industry and the financial crisis brought about unprecedented consolidation in financial services
- Bulge bracket investment banks tend to pursue transactions that support their expensive cost structures
- With such high infrastructure costs to account for, it is not surprising that the average deal size for IPOs in the United States have scaled up

IPO's in the United States by Size - Number of Deals												
Deal Size	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
0-\$25 million	9	10	6	7	19	12	9	2	1	3	1	1
\$25-\$50 million	8	7	4	33	19	22	12	1	0	4	7	2
\$50-\$100 million	20	16	20	52	44	38	44	7	7	32	17	16
\$100+ million	43	35	38	82	79	78	91	13	31	55	66	20
Total	80	68	68	174	161	150	156	23	39	94	91	39

IPO's in the United States by Size - Related Percentage of Total Number of Deals												
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
0-\$25 million	11%	15%	9%	4%	12%	8%	6%	9%	3%	3%	1%	3%
\$25-\$50 million	10%	10%	6%	19%	12%	15%	8%	4%	0%	4%	8%	5%
\$50-\$100 million	25%	24%	29%	30%	27%	25%	28%	30%	18%	34%	19%	41%
\$100+ million	54%	51%	56%	47%	49%	52%	58%	57%	79%	59%	73%	51%

Sources: Dealogic, excludes ADRs and foreign issuers. Current as of April 11, 2012.

Fewer Listed Companies Today

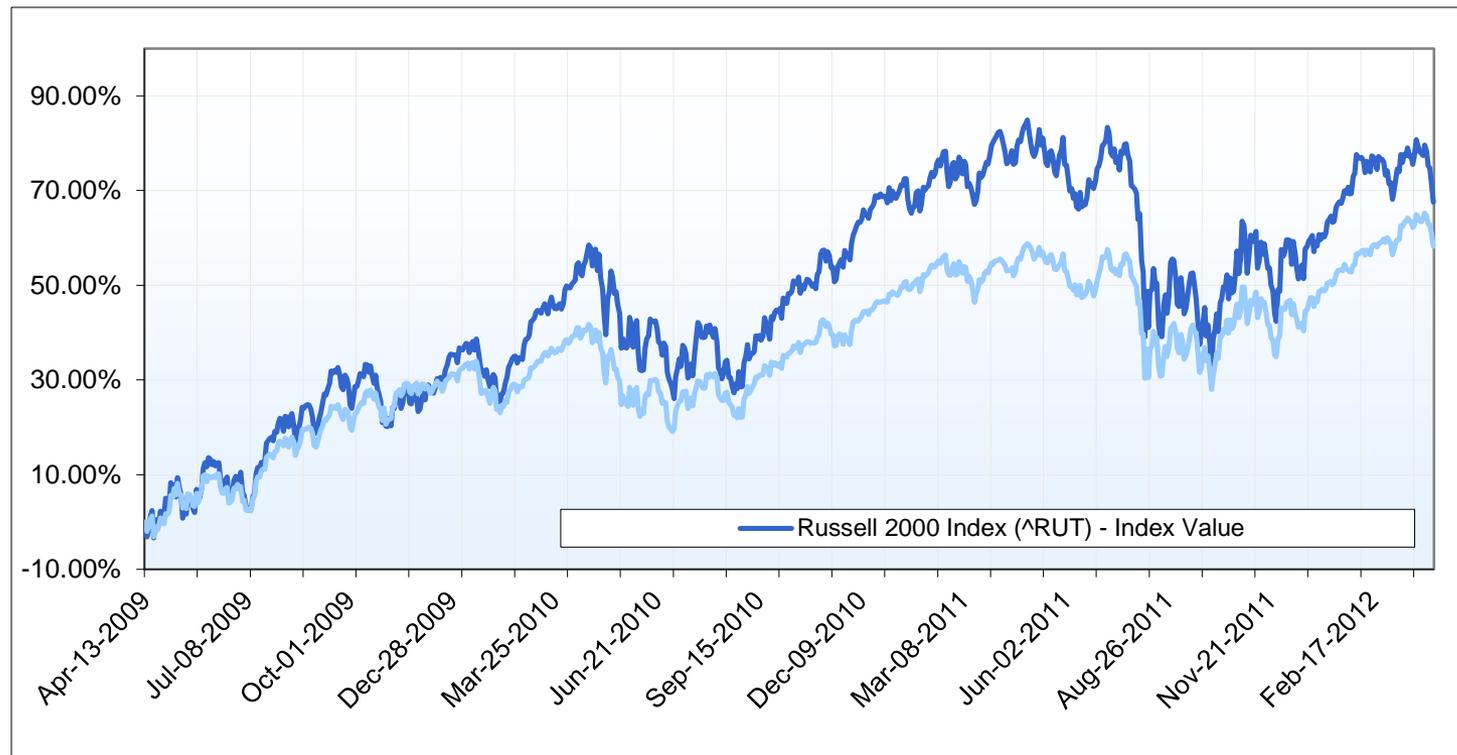
US Listing Trend		
Year	Number of Listings	Percentage Decrease
2000	9,100	-
2010	6,450	-29%
2012	5,165	-20%

- In 2000, 9,100 companies filed proxy statements with the SEC, and more recently in 2010, only 6,450 had done so
- Today, there are only 5,165 companies listed on national US exchanges, representing a 20% decrease from just two years ago

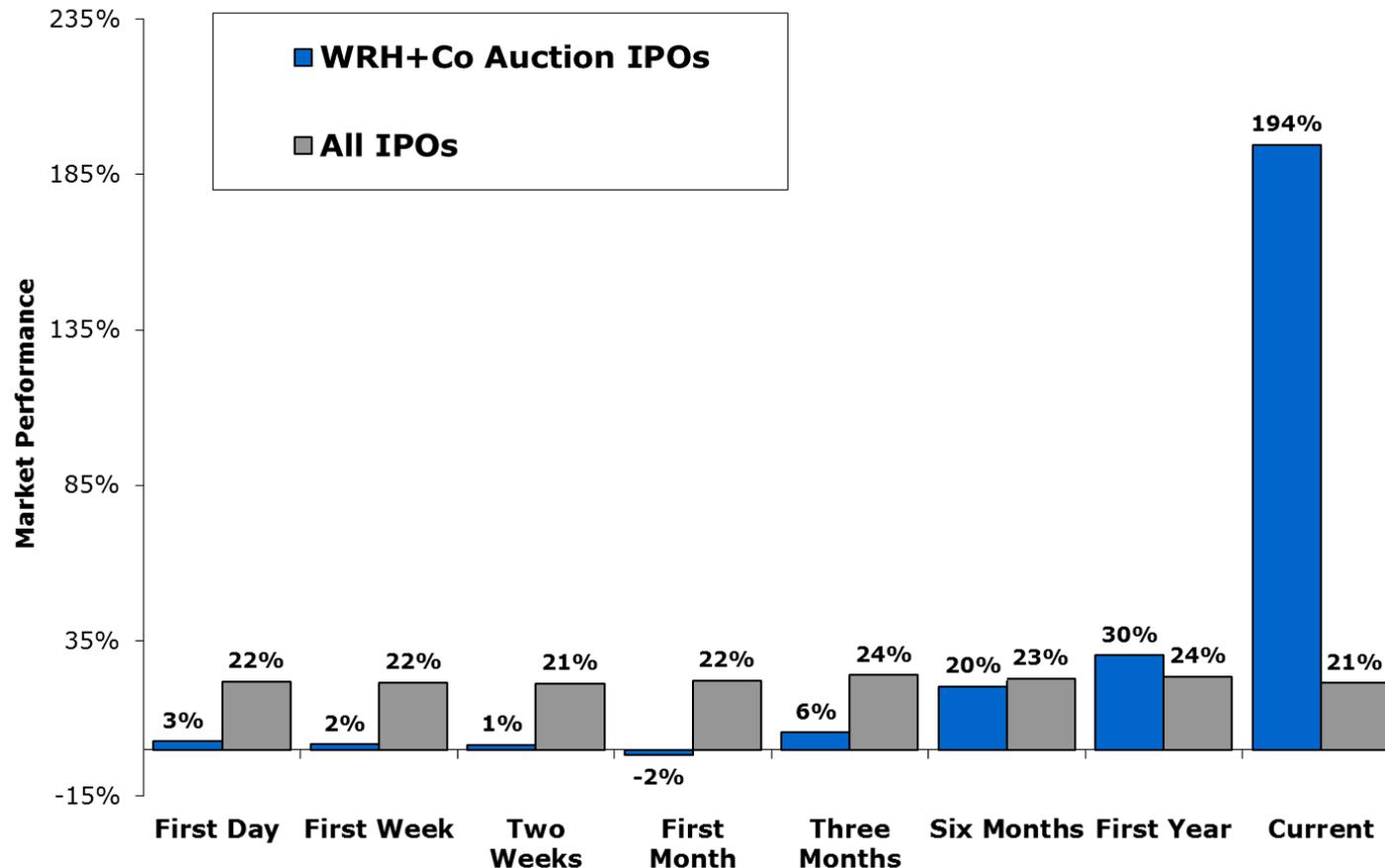
Sources: "The Demise of the IPO – and Ideas on How to Revive It," The Wall Street Journal, June 25, 2010, and CapitalIQ. Listed company data includes all companies listed on major US exchanges.

Small Cap Stock Performance – Russell 2000 vs. S&P 500

- While smaller cap companies are oftentimes more volatile than the larger cap universe, WRH+Co believes that the potential returns far outweigh the risks
- Indeed, as the chart below shows, the smaller cap Russell 2000 has outperformed the larger cap S&P 500 over the last several years



Average Performance of IPOs Since Aug 2004



Source: Dealogic and CapitalIQ

Includes common shares IPOs listed on the NYSE, Nasdaq or AMEX (now NYSE MKT) since August 2004 and excludes Specialty Acquisition Corps., Closed End Fund offerings and Demutualizations. Acquired companies' current performance is based on the acquisition price per share at close of transaction. Data is current as of April 4, 2012.

Regulation A+ Alternative to IPO

Regulation A+ IPO Structure

- A Reg A+ initial public offering would probably consist of a fixed price and fixed number of shares
- Auction could be used for consumer-based companies, or for offerings for well-known companies
- Offering would be conducted on a best efforts basis, with investors placing their capital in escrow
- Can leave the offering open until priced
- Issuer will subsequently list its shares on previously agreed upon trading venue, and WRH+Co will act as market maker

Cost of Capital – Traditional S-1 vs. Regulation A+*

- **WRH+Co is able to execute offerings more cost efficiently due to its**
 - Lack of the more costly B/D infrastructure of the bulge bracket banks, and
 - A reliance on electronic marketing and technology
- **With the revised Regulation A+ offering mechanism, WRH+Co would be able to drive the cost of capital for emerging companies even lower**

	Traditional S-1 Amount	Small S-1 Amount	Revised 1-A Amount
Total Gross Proceeds	\$50,000,000	\$50,000,000	\$50,000,000
Underwriter Spread	3,500,000	2,500,000	1,500,000
	<u>\$46,500,000</u>	<u>\$47,500,000</u>	<u>\$48,500,000</u>
SEC Registration Fee	\$5,805	\$5,805	\$5,805
FINRA Filing Fee	5,167	5,167	5,167
Listing Fee	50,000	50,000	50,000
Printing Expenses	166,667	41,667	41,667
Legal Fees and Expenses	416,667	250,000	100,000
Accounting Fees and Expenses	416,667	250,000	100,000
Transfer Agent and Registrar Fees	8,333	8,333	8,333
Roadshow and Miscellaneous	83,333	50,000	20,000
Total Approximate Expenses	<u>\$1,152,638</u>	<u>\$660,972</u>	<u>\$330,972</u>
Net Proceeds to Company	\$45,347,362	\$46,839,028	\$48,169,028

* Source: The Public Company Primer, White & Case. Note that initial estimated rates could potentially be lowered through negotiated arrangements. Also note that offering related expenses can vary significantly depending upon a number of financial, legal, and organizational factors.

Broad and Effective Retail Distribution

- WRH+Co's electronic brokerage exists to facilitate broad retail distribution
 - Preparing website to make offerings directly over Internet
- Affinity marketing leverages customer loyalty as source of demand
- Boston Beer Company – the power of retail demand
 - In response to limited affinity marketing, company received 120,000 orders from customers totaling over \$50 mm in proceeds
 - Allocated only 30,000 as there was no way to incorporate all of this demand in the traditional IPO process
 - 1 year later, over half of these retail investors still held a position
 - And 15 years later, over 9,000 still held the shares

Comprehensive Research Coverage via WRH+Co's Partnerships

- Virtua Research
 - Produces robust, interactive model that gives investors the chance to determine their own valuation assumptions
- Best in Class Independent Research Providers
 - Provide comprehensive, independent research pre and post IPO that will ensure that the market hears an emerging company's story
 - Our disruptive innovation group will provide research that highlights the disruptive elements of an issuer's business

Finding Institutions that Embrace the Value Proposition

- We would broaden the list of usual suspects to include investors that are accustomed to the risks associated with early stage, small cap issues including:
 - Venture capital firms
 - Angel networks
 - Small hedge and mutual funds
 - Knowledgeable RIAs

Regulation A+ securities

- Certain funds may have in place limitations on their purchases of “restricted securities”
- Securities sold pursuant to Regulation A+ will not be considered “restricted securities” for those funds that use the Securities Act definition in their investment policies or charter documents
- No restrictions on the resale of Regulation A+ securities
- Other funds may have limitations in their investment policies on their purchases of “illiquid securities”, but, to the extent that an issuer conducts a Regulation A+ offering and lists its securities on a national securities exchange, there will be a market for the securities

Electronic Marketing: Transforming the Distribution Process

With its electronic distribution platform, WRH+Co offers the best and most cost effective means for tapping into broad market demand

- **Using electronic distribution and technology significantly reduces offering costs and is more convenient for issuers and investors alike**
- **WRH+Co and issuer develop a targeted, SEC-compliant electronic marketing campaign**
 - Use of web-based platform for marketing materials, offering circular and order management through online auction system
 - Find the right investors – partner with appropriate distribution channels, build marketing campaign that includes e-mails to customers, partners, placement on selected websites, etc.
 - Maximum use of “Free Writing” to include:
 - Electronic road shows
 - Analyst interviews and valuation models
 - Independent research
- **Real-time video conferences with company for the benefit of investors**
- **“Virtual” roadshow augmented by targeted group events**
 - New York, Boston, San Francisco

Regulation A+ & **OpenIPO** : Process Overview

WR HAMBRECHT + CO

1. WRH+Co Due Diligence and Analytics

- WRH deal team
- Outside research

2. Company Positioning

- 3-4 reasons to own the stock

3. Timeline

- Driven by delivery of the company's audited numbers

4. Write Offering Circular

- Company drafts the Business section

5. Legal Due Diligence

- Company Counsel
- Underwriters Counsel – 10b-5 Letter

6. Aftermarket Issues

- Listing
- Alternatives for small companies
- Blue Sky issues

7. Test the Market

- Start pre-marketing before filing offering statement with the SEC

Regulation A+ & Process Overview (cont'd)

8. File with SEC

- SEC process and review issues
- SEC response to expanded use of free writing

9. Electronic Roadshow and Marketing

- Management presentation
- Free writing
 - Outside research
 - Virtua model
 - Meaningful write-ups
- Group lunches
- New York, Boston, San Francisco

10. Effectiveness

- Gather orders through the auction platform

11. Aftermarket Trading

- Shoe

12. Company IR Program

- Sector expertise

WRH+Co's Culture of Innovation

A 44-year commitment to disruption in the financial markets and raising capital for innovative companies

- **Hambrecht & Quist, 1968 - 1998**
 - Heritage and culture of delivering innovation to the marketplace
 - Successful offerings included Apple, Adobe, and Genentech, among numerous others
 - H&Q consistently generated value for its partners, which included issuers and investors alike
- **WR Hambrecht + Co, Since 1998**
 - Focused exclusively on innovative, cost-effective capital raising solutions for issuers
 - Commitment to the transparency and fairness in the capital raising process
 - Clay Christensen's theory of disruption absolutely central to WRH+Co's vision
 - Dedication to serving growing companies that are committed to marketplace disruption and innovation

Required Rulemaking

Importance of Section 3(b)(2) alternative

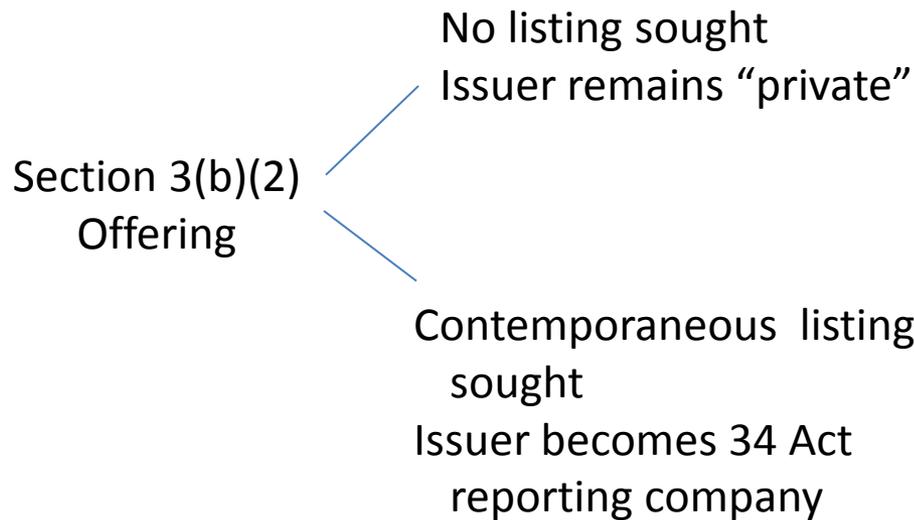
- The proposals to amend Regulation A preceded the JOBS Act, and had bipartisan support
- There is widespread recognition that smaller companies (well under the EGC \$1 billion threshold) need better access to capital
- A Section 3(b)(2) offering alternative would provide a “right-sized” IPO route for these companies and would:
 - Incorporate robust information/disclosure requirements
 - Require SEC review
 - Include a contemporaneous exchange listing
 - Post-offering require SOX compliance
 - Subsequent to “IPO”, rely on “scaled” reporting for ongoing filings

Importance of Section 3(b)(2) alternative (cont'd)

- From a regulatory and investor protection perspective, a 3(b)(2) offering should be preferable to Rule 506 offerings, “backdoor” IPOs, reverse mergers and the other alternatives often offered to smaller companies seeking capital
- Creating a viable 3(b)(2) smaller public offering framework will require a holistic approach that addresses exchange listing, research support, etc.

Suggestions for discussion

- SEC rulemaking should provide for two alternatives



- Preserve election as to format of offering statements
- Require audited financial statements
- Clarify that auditors need not be PCAOB-registered
- Require some ongoing public reporting

- Require issuer to use S-1 format, albeit with disclosure accommodations
- Reconcile disclosure requirements so that Form 10 items are satisfied
- Amend Form 8-A to facilitate listing
- Clarify EGC status for these issuers and make EGC benefits available to them
- Promote research for these issuers

Suggestions for discussion

- **Eligible issuers:** U.S. or Canadian domiciled, not Exchange Act reporting at time of Section 3(b)(2) offering, permit BDCs
- **Ineligible issuers:** specifically prohibit SPACs, blind pools, trusts
- **Selling securityholders:** permit use of 3(b)(2) for offerings by selling securityholders
- **Qualified purchasers:** align with original legislative proposals, to include investors purchasing through a registered broker-dealer (addresses investor protection concerns with broker-dealer acting as gatekeeper)
- **National exchange:** clarify that the JOBS Act reference to exchange contemplated that a 3(b)(2) offering with contemporaneous listing on a securities exchange would provide for blue sky preemption
- **Disclosure requirements:** use existing Form 1-A as a starting point for disclosure requirements
- **Electronic filing:** permit electronic filing of Form 1-A, following some optional confidential submission period

Suggestions for discussion (cont'd)

- **Review of disclosures:** provide for streamlined SEC review for at least those issuers that intend to list securities on an exchange
- **State participation:** to the extent that states will be involved in the review of those offering statements for issuers that elect to remain non-reporting, then adopt a uniform standard (perhaps updating Form U-7)
- **Ongoing disclosures:** for those issuers that choose to remain non-reporting companies, mandate annual filing and filing of Form 8-K type disclosures in connection with certain material events

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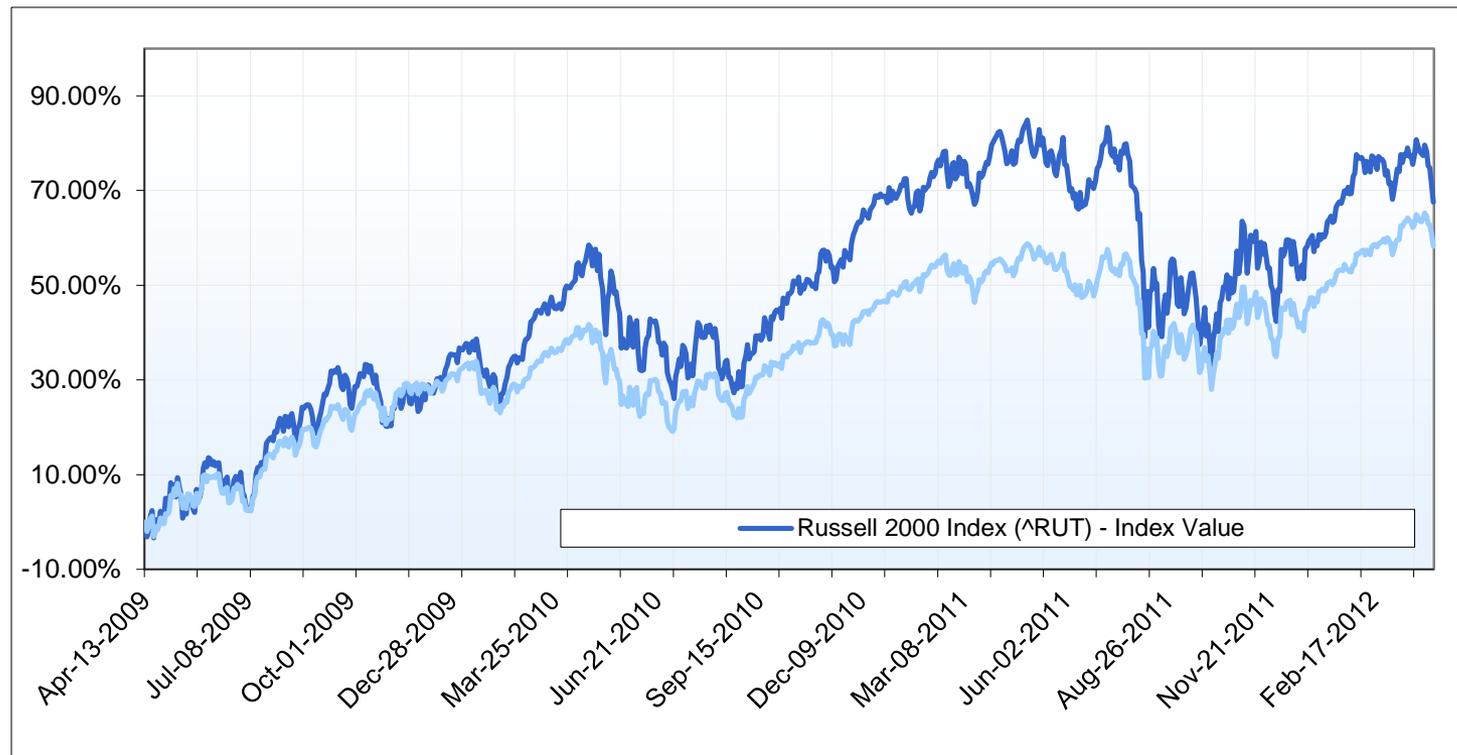
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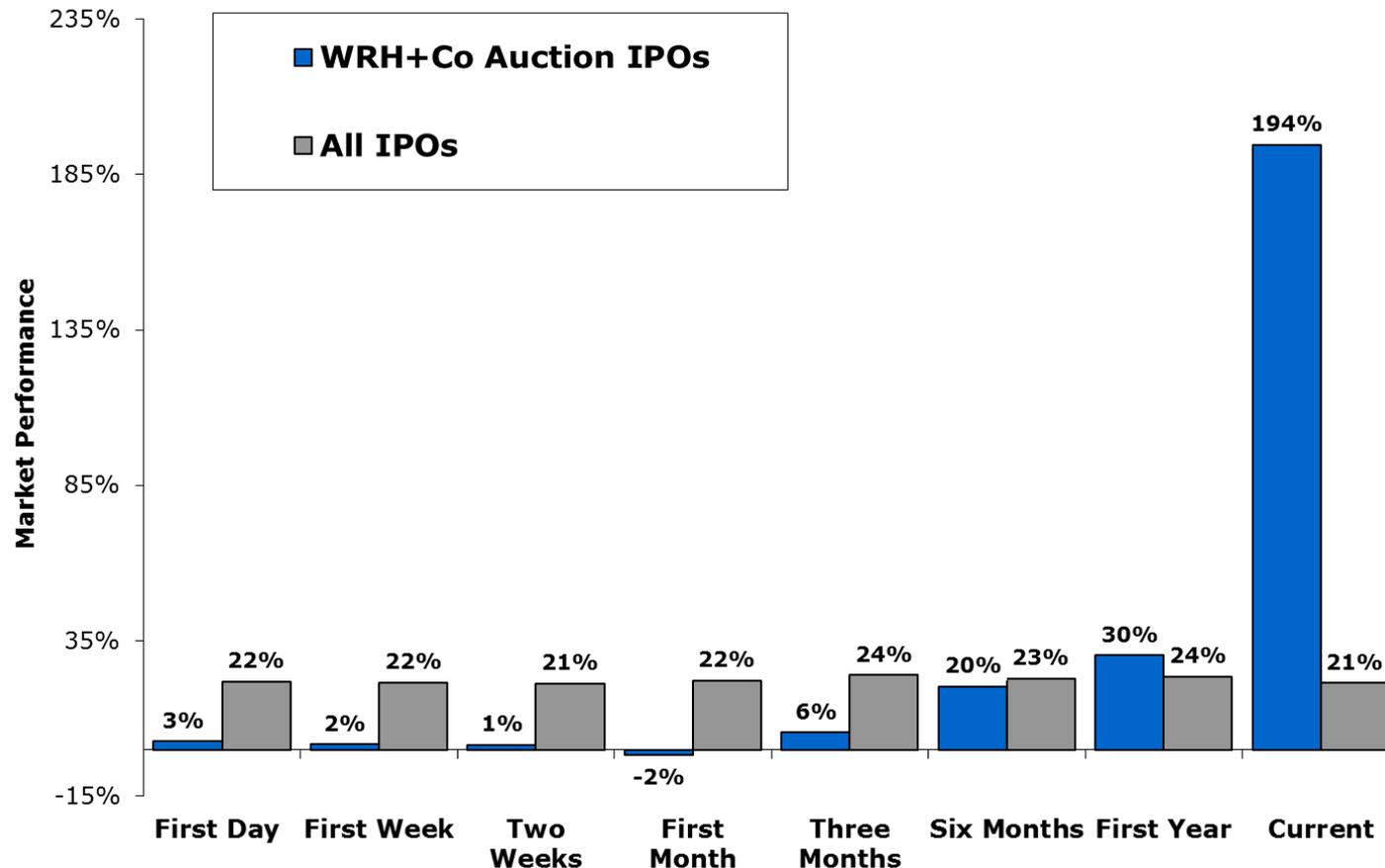
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Importance of Section 3(b)(2) alternative

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Suggestions for discussion

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Section 3(b)(2)
Offering

- No listing sought
Issuer remains “private”



- Preserve election as to format of offering statements
- Require audited financial statements
- Clarify that auditors need not be PCAOB-registered
- Require some ongoing public reporting

- Contemporaneous listing sought
Issuer becomes 34 Act reporting company



- Require issuer to use S-1 format, albeit with disclosure accommodations
- Reconcile disclosure requirements so that Form 10 items are satisfied
- Amend Form 8-A to facilitate listing
- Clarify EGC status for these issuers and make EGC benefits available to them
- Promote research for these issuers

Suggestions for discussion

- **Eligible issuers:** U.S. or Canadian domiciled, not Exchange Act reporting at time of Section 3(b)(2) offering, permit BDCs
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