

Advisory Committee on Small and Emerging Companies

May 1, 2013

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.

Fewer Listed Companies Today

US Listing Trend		
Year	Number of Listings	Percentage Decrease
2000	9,100	–
2010	6,450	-29%
2013	4,128	-36%

- In 2000, 9,100 companies filed proxy statements with the SEC, and more recently in 2013, only 4,128 had done so

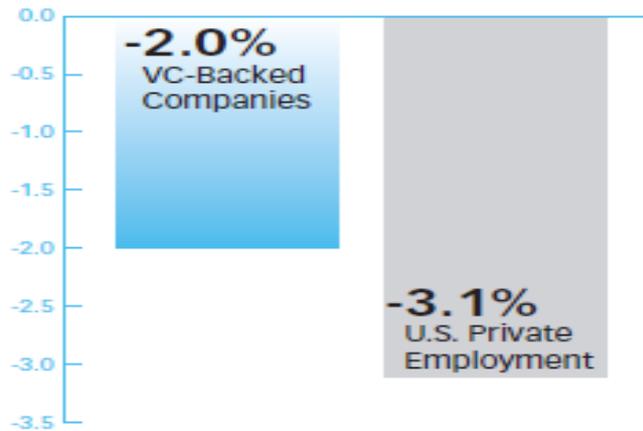
Sources: The Wall Street Journal and CapitalIQ. Listed company data includes all companies listed on major US exchanges. Current as of 4/23/2013.

Venture-backed companies and job growth

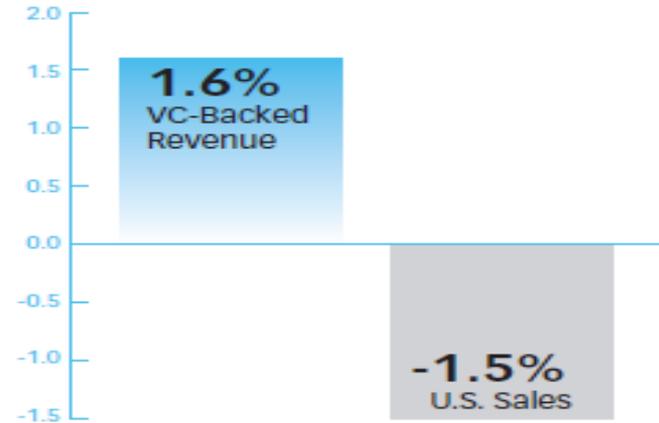
- Industry data and academic studies have shown that venture capital in the United States has driven the growth of innovative companies
- These innovative companies create new jobs and contribute to revenue and GDP growth

Venture-Backed Companies Outperformed Total U.S. Economy 2008 – 2010

Employment Growth



Revenue Growth



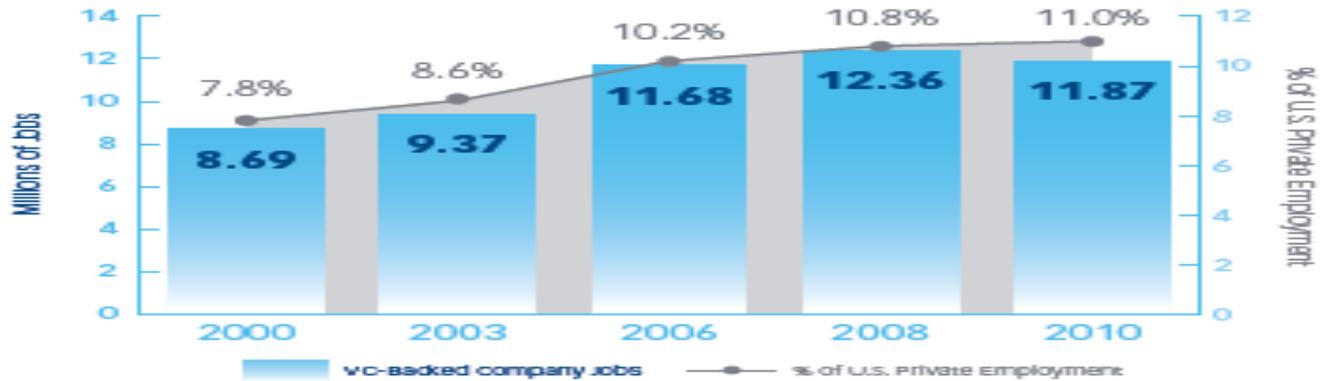
For every dollar of venture capital invested from 1970 to 2010, \$6.27 of revenue was generated in 2010.



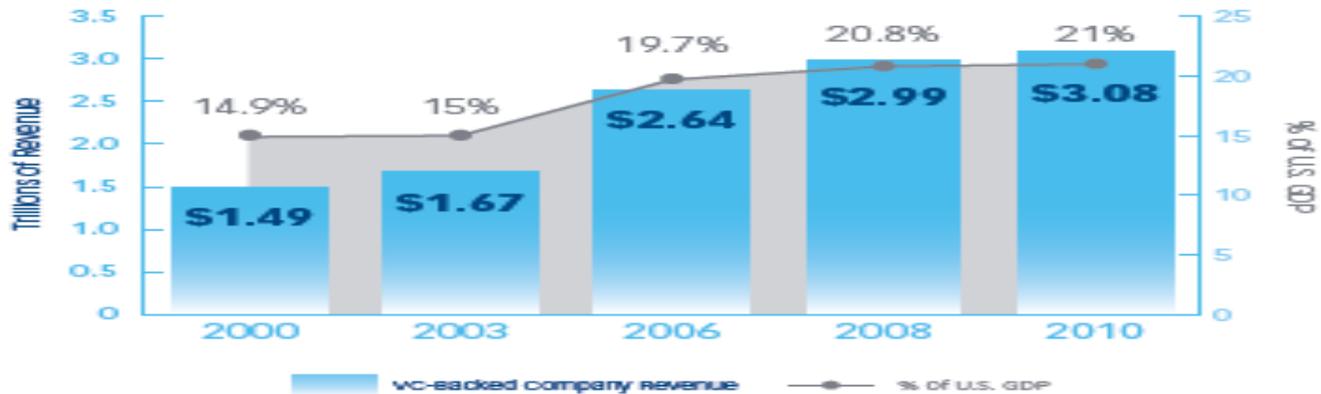
Annual venture investment equals less than 0.2 percent of U.S. GDP. Annually, VC-backed companies have generated revenue equal to 21 percent of U.S. GDP.

Source: National Venture Capital Association

U.S. Venture-Backed Company Employment 2000 – 2010



U.S. Venture-Backed Company Revenue 2000 – 2010



Source: National Venture Capital Association

Top 5 States for U.S. VC-Backed Company Employment

RANK	STATE	VC-BACKED COMPANY EMPLOYMENT
1	California	2,887,063
2	Texas	1,129,551
3	Pennsylvania	783,527
4	Washington	778,579
5	Massachusetts	775,151

Top 5 States for U.S. VC-Backed Company Revenue

RANK	STATE	VC-BACKED COMPANY REVENUE
1	California	\$845,601,000
2	Washington	\$256,081,000
3	Texas	\$242,608,000
4	Pennsylvania	\$238,383,000
5	Massachusetts	\$189,722,000

Source: National Venture Capital Association

VC exits

- IHS Global Insight research suggests that 92% of job growth for young companies occurs after their IPOs
- A Kauffman Foundation Report, “Post-IPO Employment and Revenue Growth for U.S. IPOs, June 1996 – December 2010,” also catalogues the average job creation in the years following a company’s IPO
- However, most VC exits are occurring through M&A and not through IPOs

VC Exits since 2007

Venture Capital Exits since 2007							
Year	Total M&A Deals	Total M&A Deals with Disclosed Values	Total Disclosed M&A Value (\$M)	Avg. M&A Deal Size (\$M)	Number of IPOs	Total Offer Amount (\$M)	Avg. IPO Offer Amount (\$M)
2007	488	200	30,745.5	153.7	92	12,365.5	134.4
2008	416	134	16,236.9	121.2	7	765.0	109.3
2009	351	108	12,364.9	114.5	13	1,979.8	152.3
2010	521	149	17,700.3	118.8	68	7,609.1	111.9
2011	488	169	24,093.2	142.6	51	10,689.5	209.6
2012	435	120	21,563.2	178.9	49	21,451.2	437.8

Source: National Venture Capital Association

JOBS ACT

JOBS Act

- The JOBS Act recognized the effect of all of these trends on job creation in the United States and had as its principal objective promoting access to capital formation so innovative, emerging companies would have an opportunity to grow
- The centerpiece of the JOBS Act has become the Title I IPO “on-ramp” provisions for emerging growth companies

JOBS Act — Title I

- The IPO “on-ramp” provisions have proven a success, with quite a number of strong companies coming to market with IPOs
 - In part, by phasing in certain corporate governance and disclosure requirements and timing these so that they become effective once a company is more mature, the JOBS Act has helped eliminate a psychological barrier that arose post Sarbanes-Oxley
 - Title I also permits confidential submissions, which has proven to be valuable to companies, and which has become an efficient process
 - Title I also recognizes that certain of the communications rules were outmoded and permits pre-market testing
 - Title I also acknowledges that equity research is essential to the success of emerging growth companies and takes steps to promote pre-deal research and eliminates artificial quiet periods
 - All of these are significant accomplishments, but much more remains to be done

Smaller company IPOs

- Before the IPO “on-ramp” provisions were contemplated and, in fact, several years prior to the JOBS Act, WR Hambrecht + Co had recommended that Congress consider amending existing Regulation A by raising the dollar threshold and modernizing the provisions of the exemption as a means of addressing the drought in small company IPOs
- We still believe that Title IV, or Regulation A+, will be an important part of the solution for smaller companies
- There is widespread recognition that smaller companies (well under the EGC \$1 billion threshold) need better access to capital
- The IPO on-ramp is not the answer for smaller companies; the IPO on-ramp is still a steep climb for companies that would like to undertake modest-sized (or small) IPOs

Smaller company IPOs (cont'd)

- The dynamics of the IPO market have changed and there is no appetite for smaller offerings, yet smaller offerings often result in enormous successes
 - In July 1986, Adobe Systems filed to sell 500,000 shares at \$10 to \$11 dollars, or approximately \$5 million. At the time the company was four years old and had 49 employees. The public markets provided Adobe with the capital to grow, create jobs and stay independent of OEMs.
 - It's easy to forget the Starbucks, AOL, Peet's Coffee, Whole Foods, Panera Bread, Odwalla, Intel, Amazon, Oracle and Cisco all raised less than \$50 million in their IPOs.
- In today's market, any of these would be considered too small a deal for most investment banks to consider; the IPO process (even with the "on-ramp" provisions) would prove too expensive for the company; and there would be no assurance of research coverage for a company that completed a small IPO

Smaller company IPOs (cont'd)

- What alternatives are available today?
 - A reverse merger
 - An SPAC
 - A back-door quotation on the OTC BB
 - Successive Reg. D offerings with no public disclosures and no traded stock
 - Eventually, perhaps, crowdfunding?
- None of these alternatives is attractive to a VC or to a founder and none of these should be compelling to regulators as these do not provide investor protections

Importance of Section 3(b)(2) alternative

- 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
- Given that 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, and it is surprising that this Advisory Committee has not supported Title IV rulemaking as a priority
- Creating a viable 3(b)(2) smaller public offering framework will require a holistic approach that addresses exchange listing, research support, etc.

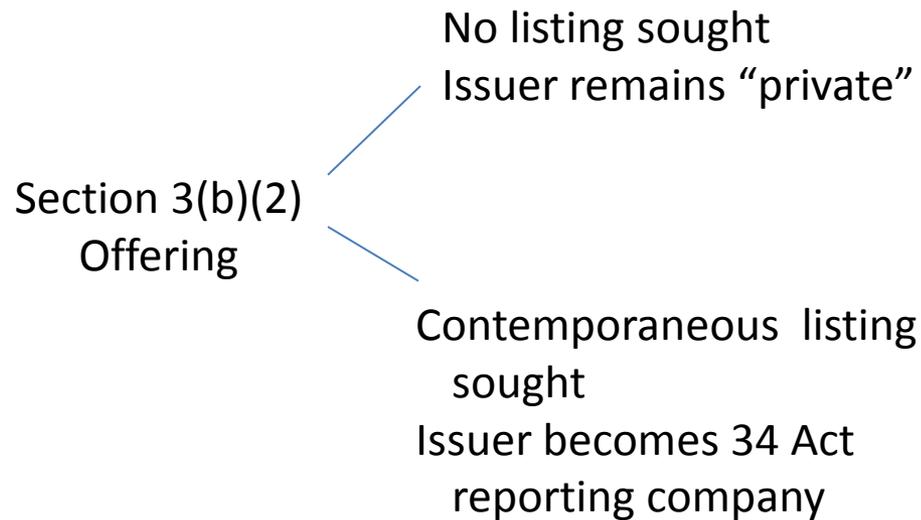
Required rulemakings

- The SEC has significant rulemakings to address, including the Rule 506 final rules, bad actor provisions, and crowdfunding
- All of these have deadlines
- The JOBS Act did not provide a deadline for rulemaking under Title IV for Regulation A+
- However, it is Regulation A+ (and not crowdfunding) that can make a real difference in capital formation for smaller companies

Section 3(b)(2) Recommendations

Recommendations

- 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

Recommendations (cont'd)

- **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

Recommendations (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

Investor protection and funding alternatives

- It is essential that we step back and consider the types of capital-raising alternatives that we are promoting, and if we fail to act, those capital-raising alternatives on which smaller companies will be relegated to rely if they want to remain independent
- State regulators and others have expressed concerns about Title IV. Currently, smaller companies will continue to be shut out of the IPO market unless they can execute a \$100 million offering
- Smaller companies of the sort that have significant growth potential and can create jobs will never find the amounts that can be raised in crowdfunding sufficient, nor does crowdfunding provide an exit
- Unless Regulation A+ is made a viable alternative, companies will rely on Reg D offerings where there are no disclosure requirements and trading in secondary markets without uniform or robust disclosures

Reinvigorating the IPO Market

The IPO Market

- Regulation A+ should be an immediate and high priority
- But, we should also recognize that even after the JOBS Act, there are many important issues that must be addressed in order to reinvigorate the IPO market

Factors Affecting the IPO Market

- It would be an oversimplification to attribute the decline of IPOs to regulation. In fact, there have been many, many factors that have contributed
 - consolidation of major investment and commercial banks and the disappearance of independent boutiques and regional banks
 - shrinking of the institutional brokerage business
 - the perceived disfunctions of the underwriting business. Facebook is only one isolated example.
 - short-term trading bias that increases volatility
 - the cost of an IPO and the costs associated with being a public company, including litigation costs
 - structural changes that have left the ordinary investor out of the market
 - the disappearance of regional exchanges

Recommendations

- Eliminate deep discount pricing
 - introduce a “best execution” rule for IPOs
 - make IPO shares available through a selling group to bona fide buyers (ordinary investors)
 - require underwriters to provide the issuer and the SEC with the list of IPO allocations
 - encourage alternatives to the book building process, including auctions

Auctions

- It is true that relatively few companies have relied on auctions for their IPOs; however, auctions improve pricing
- Auction-based IPOs are among the best-performing IPOs

Auction-based IPOs are among the best performing

Top 100 IPOs Since 2004 - Overall Market Performance from Offer to Current

	Issuer Name	Ticker Symbol	Pricing Date	Market Value (\$) (Post Deal incl Ovl)	% Change Price Offer/Current
1	Pharmasset Inc	VRUS	26-Apr-07	184,678,029	2,943.78
2	Chipotle Mexican Grill Inc	CMG	25-Jan-06	714,881,618	1,549.23
3	New River Pharmaceuticals Inc	NRPH	5-Aug-04	142,103,104	1499.50
4	Bucyrus International Inc	BUCY	22-Jul-04	359,992,386	1,433.33
5	Salesforce.com Inc	CRM	22-Jun-04	1,113,825,680	1,366.18
6	MasterCard Inc	MA	24-May-06	5,263,803,870	1,238.74
7	CF Industries Holdings Inc	CF	10-Aug-05	880,000,000	1,013.38
8	Google	GOOG	18-Aug-04	23,053,669,655	841.31
9	Under Armour Inc	UARM	17-Nov-05	602,857,463	750.15
10	NetLogic Microsystems Inc	NETL	8-Jul-04	225,623,532	733.33
11	Lululemon Athletica Inc	LULU	26-Jul-07	1,215,301,104	721.00
12	Concho Resources Inc	CXO	2-Aug-07	833,748,977	640.96
13	MW Veterinary Supply Co	MWV	2-Aug-05	168,193,495	635.59
14	TransDigm Group Inc	TDG	14-Mar-06	928,234,188	596.00
15	Acorda Therapeutics Inc	ACOR	9-Feb-06	114,282,132	567.17
16	Rightnow Technologies Inc	RNOW	5-Aug-04	199,401,230	514.29
17	Digital Realty Trust Inc	DLR	28-Oct-04	635,312,772	510.42
18	Copa Holdings SA	CPA	14-Dec-05	875,000,000	500.00
19	IHS Inc	IHS	10-Nov-05	1,077,083,360	497.88
20	IntercontinentalExchange Inc	ICE	15-Nov-05	1,442,135,578	497.19
21	Westlake Chemical Corp	WLK	10-Aug-04	917,414,754	475.31
22	Atlas America Inc	ATLS	10-May-04	201,319,162	469.61
23	MercadoLibre Inc	MELI	9-Aug-07	796,078,206	420.22
24	Herbalife Ltd	HLF	15-Dec-04	923,220,116	414.71
25	athenahealth Inc	ATHN	19-Sep-07	568,807,182	414.22
26	Allegiant Travel Co	ALGT	7-Dec-06	342,826,794	411.17
27	Continental Resources	CLR	14-May-07	2,520,279,540	404.13
28	Chart Industries Inc	GTLS	25-Jul-06	383,820,735	394.67
29	Signature Bank	SBNY	22-Mar-04	382,850,000	392.45
30	CommVault Systems Inc	CVLT	21-Sep-06	603,939,906	386.76
31	ArcSight Inc	ARST	13-Feb-08	278,469,135	383.56
32	Ulta Salon Cosmetics & Fragrance Inc	ULTA	24-Oct-07	1,020,116,250	371.33
33	Emergency Medical Services Corp	EMS	15-Dec-05	129,476,550	356.93
34	Innophos Holdings Inc	IPHS	2-Nov-06	255,600,000	339.33
35	Telvent GIT SA	TLVT	21-Oct-04	264,195,000	338.56
36	Beacon Roofing Supply Inc	BECN	22-Sep-04	342,668,651	328.88

Auction-based IPOs are among the best performing (cont'd)

37	Orchids Paper Products	TIS	14-Jul-05	31,000,000	324.12
38	Aegerion Pharmaceuticals Inc	AEGR	22-Oct-10	167,230,742	323.89
39	CBOT Holdings Inc	BOT	18-Oct-05	2,825,723,124	321.30
40	Pacira Pharmaceuticals Inc	PCRX	2-Feb-11	116,630,136	319.43
41	Wright Express Corp	WXS	15-Feb-05	724,842,000	300.61
42	Alnylam Pharmaceuticals Inc	ALNY	27-May-04	115,699,992	294.50
43	LinkedIn	LNKD	18-May-11	4,305,358,215	293.82
44	ITC Holdings Corp	ITC	25-Jul-05	763,567,202	291.57
45	Ellie Mae Inc	ELLI	14-Apr-11	122,400,804	289.33
46	SolarWinds Inc	SWI	19-May-09	802,329,350	288.24
47	MediData Solutions Inc	MDSO	24-Jun-09	312,951,744	286.43
48	IPG Photonics Corp	IPGP	12-Dec-06	707,524,406	277.58
49	International Securities Exchange Inc	ISE	8-Mar-05	650,502,000	274.94
50	Visa Inc	V	18-Mar-08	44,319,868,912	271.66
51	Inhibitex Inc	INHX	3-Jun-04	122,469,270	271.43
52	Amerisafe Inc	AMSF	17-Nov-05	147,736,773	266.67
53	Domino's Pizza Inc	DPZ	12-Jul-04	961,150,764	263.43
54	Blackbaud Inc	BLKB	21-Jul-04	348,285,352	263.13
55	Standard Parking Corp	STAN	27-May-04	118,429,542	262.78
56	MarketAxess Holdings Inc	MKTX	4-Nov-04	290,794,603	261.09
57	Rackspace Hosting Inc	RAX	7-Aug-08	1,443,060,100	255.04
58	EnerSys	ENS	29-Jul-04	574,319,988	252.64
59	Mellanox Technologies Ltd	MLNX	7-Feb-07	506,599,099	248.53
60	Morningstar Inc	MORN	2-May-05	711,262,359	247.08
61	CPFL Energia SA	CPL	28-Sep-04	2,708,697,150	244.33
62	Mead Johnson Nutrition Co	MJN	10-Feb-09	4,908,000,000	240.50
63	Sourcefire Inc	FIRE	8-Mar-07	346,708,380	240.40
64	SPS Commerce Inc	SPSC	21-Apr-10	138,425,316	239.58
65	Boji Holding Inc	BOFI	14-Mar-05	86,222,964	236.96
66	Solera Holdings Inc	SLH	10-May-07	1,039,712,160	236.13
67	RBC Bearings Inc	ROLL	9-Aug-05	224,286,406	235.52
68	VistaPrint Ltd	VPRT	29-Sep-05	476,390,820	233.33
69	Synchronoss Technologies Inc	SNCR	15-Jun-06	247,200,000	233.13
70	DSW Inc	DSW	28-Jun-05	795,438,173	233.00
71	WellCare Group Inc	WCG	30-Jun-04	604,542,338	232.18
72	Extra Space Storage Inc	EXR	11-Aug-04	351,749,375	232.16
73	Hittite Microwave Corp	HITT	21-Jul-05	474,027,745	231.24
74	Omniure Inc	OMTR	27-Jun-06	293,188,513	231.08
75	Taleo Corp	TLEO	28-Sep-05	305,596,620	228.43
76	FleetCor Technologies Inc	FLT	14-Dec-10	1,810,540,358	227.39

Auction-based IPOs are among the best performing (cont'd)

77	Liquidity Services Inc	LQDT	22-Feb-06	273,295,540	223.40
78	Atheros Communications Inc	ATHR	11-Feb-04	636,324,276	221.36
79	Blackboard Inc	BBBB	17-Jun-04	352,364,838	221.29
80	Rockwood Holdings Inc	ROC	16-Aug-05	1,414,354,040	216.25
81	Hornbeck Offshore Services Inc	HOS	25-Mar-04	266,861,582	211.46
82	Acme Packet Inc	APKT	12-Oct-06	538,721,155	207.74
83	Targa Resources Corp	TRGP	6-Dec-10	930,432,382	207.50
84	Celanese Corp	CE	20-Jan-05	2,538,804,336	204.81
85	Team Health Holdings Inc	TMH	15-Dec-09	772,752,000	203.67
86	NetSuite Inc	N	19-Dec-07	1,547,278,356	202.88
87	Koppers Holdings Inc	KOP	31-Jan-06	289,998,688	201.36
88	Guidewire Software Inc	GWRE	24-Jan-12	652,865,863	197.69
89	Zumiez Inc	ZUMZ	5-May-05	237,244,698	197.33
90	Tesla Motors Inc	TSLA	28-Jun-10	1,589,137,832	195.24
91	Starent Networks Corp	STAR	5-Jun-07	749,009,544	191.42
92	Shutterfly Inc	SFLY	28-Sep-06	354,166,920	191.40
93	Proto Labs Inc	PRLB	23-Feb-12	381,323,328	190.56
94	Riverbed Technology Inc	RVBD	20-Sep-06	627,420,271	190.05
95	Vitamin Shoppe Inc	VSI	27-Oct-09	451,728,692	189.24
96	Stanley Inc	SXE	17-Oct-06	259,502,880	188.54
97	Financial Engines Inc	FNGN	15-Mar-10	482,912,172	186.92
98	Sears Hometown & Outlet Stores Inc	SHOS	9-Oct-12	346,500,000	184.60
99	Fortinet Inc	FTNT	17-Nov-09	822,737,113	184.48
100	Crosstex Energy Inc	XTXI	12-Jan-04	228,800,286	183.54

Source: Dealogic

Recommendations

- Level the playing field for ordinary investors
 - require research to be made available to all investors
 - require that the company's roadshow presentation be made available to all investors
- Extend Regulation FD to IPOs
- Review disclosure requirements
 - Investors face information overload — most IPO prospectuses are now hundreds of pages; risk factor disclosures may span thirty or forty pages
 - Make issuers responsible for identifying the most important risks, trends, etc.
- Reform the litigation process
 - Market participants are afraid to take advantage of even the JOBS Act accommodations