Rebuilding the IPO On-Ramp

Putting Emerging Companies, Investors and the Job Market Back on the Road to Growth

October 20, 2011
Agenda

- IPO Task Force Members
- IPOs In Decline Last 15 Years
- IPOs Support Innovation & Create Jobs
- Structural & Regulatory Elements Impacting IPOs
- Four Simple Steps to Tilt Balance Back
IPO Task Force Members

<table>
<thead>
<tr>
<th>Venture Capitalists</th>
<th>Securities Attorneys</th>
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<tbody>
<tr>
<td>- Kate Mitchell, Scale Venture Partners, Task Force Chairman</td>
<td>- Joel Trotter, Latham &amp; Watkins</td>
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<td>- Mark Gorenberg, Hummer Winblad Partners</td>
<td>- Steve Bochner, Wilson, Sonsini, Goodrich &amp; Rosati</td>
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<td>- Tom Crotty, Battery Ventures</td>
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<td><strong>Public Investors</strong></td>
<td><strong>Academiicians/Accountants</strong></td>
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<tr>
<td>- Jeff Cardon &amp; Karey Barker, Wasatch Advisors</td>
<td>- Bill Sahlman, Harvard School of Business</td>
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<td>- Henry Ellenbogen, T. Rowe Price</td>
<td>- Carol Stacey, S.E.C. Institute</td>
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<td></td>
<td>- Chuck Robel, private investor &amp; retired head of PWC Tech Practice</td>
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<td><strong>Entrepreneurs</strong></td>
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<td>- Magid Abraham Ph.D., CEO, Comscore</td>
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<td>- Josh James, former CEO, Omniture</td>
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<tr>
<td>- Desh Deshpande, former CEO and co-founder Cascade Communications &amp; Sycamore Networks and co-chair of NACIE</td>
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<td><strong>Investment Bankers</strong></td>
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<td>- Paul Deninger, Evercore</td>
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<tr>
<td>- Carter Mack, JMP Securities</td>
<td></td>
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<tr>
<td>- Brent Gledhill &amp; Brett Paschke, William Blair</td>
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<td><strong>Additional Support From:</strong></td>
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<tr>
<td>- Investors, CEOs, NYSE, NASDAQ, NVCA</td>
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Emerging Company IPOs Have Dropped Dramatically
IPOs Are Down…Particularly Smaller IPOs

- Pre-1999, Majority of IPOs Were Done for Emerging Growth Companies
- Sub $50M Deal-Sizes Were More Common than Larger Deals
- Shift to Larger Deals Impacts IPO Ecosystem: Issuers, Small IBs, Institutional Buyers

**Pre-1999 Avg**
547 IPOs / Year

**Post-1999 Avg**
192 IPOs / Year

Source: JMP Securities, Dealogic, Capital Markets Advisory Partners, Grant Thornton
...And the Time to IPO Has Doubled

Average Age Since Company Inception (in Years) at IPO

Median Age at IPO

Early 1980s

4.8 Years

Since 2007

9.4 Years

Source: Thomson Reuters/National Venture Capital Association
Shift to M&A – Resulting in Fewer U.S. Jobs

Source: Thomson Reuters/National Venture Capital Association (Based on number of exits per year; M&A exits are for private company sales only.)
Emerging Growth IPOs Are Critical to The U.S. Economy
Innovative Startups Become Market Leaders

Web

Google
Linkedin
Yahoo!
MapQuest
Amazon.com
Ebay
Pandora
OpenTable

High Tech

Sun
Oracle
HP
Apple
Cisco
Intel
Salesforce.com

Retail / Services

FedEx
Starbucks
Staples
GAP

Life Science

Allscripts
Genentech
Athena Health

Cleantech

eTesla
A123 Systems
Innovative Companies Create Jobs and Grow Quickly

VC-Backed U.S. Revenues ($T)  As a % of Total U.S. GDP in 2008 - 2010  Outpaces 2008-2010 Total U.S. Sales Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>VC-Backed</th>
<th>As a % of Total U.S. GDP</th>
<th>Outpaces 2008-2010 Total U.S. Sales Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$1.5</td>
<td>0%</td>
<td>$1.5</td>
</tr>
<tr>
<td>2003</td>
<td>$1.7</td>
<td>0%</td>
<td>$1.7</td>
</tr>
<tr>
<td>2006</td>
<td>$2.9</td>
<td>21%</td>
<td>$2.9</td>
</tr>
<tr>
<td>2010</td>
<td>$3.1</td>
<td>21%</td>
<td>$3.1</td>
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</table>

Former Startups Now Generate 21% of U.S. GDP & Were Able To Grow Even Through The Recent Recession

IPOs Finance Significant Job Creation

92% of Job Growth in a Company Occurs Post-IPO
86% Post-IPO Job Growth Per August 2011 Survey of 2006+ IPOs

Elements of the IPO Problem
Challenges for Emerging Growth Company IPOs

- Supply Down
  - Increased Regulation Makes IPO More Costly
  - Less Likely to “Invest” in IPO in Uncertain Market

- Channel Evolution
  - Regulations Favor High-Volume, Low-Cost Trades
  - Shift In Economics From Investing to Trading

- Weak Link To Demand
  - IPO Shares Allocated to Traders vs. Investors
  - Decrease in Information Available Pre- & Post-IPO
Supply: Post-IPO CEO Survey
Costs of Going and Staying Public Are High

Average Cost $2.5M to Go Public

Annual Cost $1.5M to Stay Public

Costs Including SOX, Legal, Accounting

Source: IPO Task Force August 2011 CEO survey of incremental IPO costs from 35 CEOs of companies that went public since 2006; Consistent With Independent Review of Public Filings for 47 2011 IPO’s Raising Less Than $200M (Avg. Cost of $3M for IPO)
Channel Focus: Trading Drives Revenue For Largest Investment Banks

- Large Bank Client Base Dominated by Traders vs. Investors
- High Frequency Trading Up From <25% to 75% of Volume Over Last 5 Years
- Research Focused on Large-Cap Stocks That Drive Revenue

Source: JMP Securities
Demand Exists: Emerging Company IPOs Deliver Returns To Investors

- **Myth**: Small-Cap IPOs Lag in Performance
- **Truth**: Small-Cap Performance Equal or Exceed Large-Cap IPOs

<table>
<thead>
<tr>
<th>Post-IPO Market Cap</th>
<th>1 Day</th>
<th>1 Month</th>
<th>3 Months</th>
<th>6 Months</th>
<th>1 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200-$500</td>
<td>Average</td>
<td>27.5%</td>
<td>34.8%</td>
<td>45.1%</td>
<td>43.9%</td>
</tr>
<tr>
<td>$1B or more</td>
<td>Average</td>
<td>35.9%</td>
<td>39.7%</td>
<td>37.7%</td>
<td>32.8%</td>
</tr>
</tbody>
</table>

- Investor Interviews Showed:
  - Strong Performance & Demand for IPOs
  - Challenge to Get Allocation of Shares
  - Decline in Availability of Research for IPO Companies

Source: JMP Securities, Dealogic
Note: Includes all IPOs from 1/1/2001 – 9/30/2011
IPO Task Force Draft Recommendations
Four Draft Recommendations to Stimulate IPOs

- **Increase Supply**
  - Provide Regulatory “On Ramp” For Emerging Growth Companies

- **Improve Channel**
  - Improve Availability of Information for Investors
  - Educate Issuers on How to Work With Banks Effectively

- **Incent Demand**
  - One-Time IPO Tax Incentive to Buy & Hold IPO Shares
The Solution: Create Regulatory “On Ramp”

Create a New Category of Issuer: Emerging Growth Company

- Measurement begins at IPO
- Ends with 10-K for the earliest year in which:
  - Annual Gross Revenue Exceeds $1 Billion
  - Company Becomes Well-Known Seasoned Issuer
  - Fifth Anniversary of IPO Effective Date
- Emerging Growth Companies Enter an “On Ramp” that provides scaled regulation (details next slide)
  - Builds on Existing Scaled Disclosure Rules for Smaller Reporting Companies
- Status is Temporary & Transitional
  - Impacts 14% of Companies & 3% of Total Market Capitalization Today
- Goal: Reduced Costs For IPO Candidates While Maintaining Investor Protection
The Solution:
Scaled Regulation During Regulatory “On Ramp”

“On Ramp” Modifications to Current and Pending Rules:

- Two years of audited financial statements at IPO instead of three
  - Financial statements & selected financial data accumulate until full presentation at Year 3
- Scaled MD&A and executive comp disclosure
- Exemption from:
  - Auditor attestation of ICFR — SOX 404(b)
  - Say-on-pay, say-on-frequency and say-on-parachute votes
  - Conflict minerals disclosure requirements
  - Pay-for-performance disclosure requirements
  - CEO pay ratio requirements
- Modifications and Extended Adoption of New FASB Standards & PCAOB Rules

Scaled Regulation to Apply Only During “On Ramp” Transition
The Solution: Improve Investor Communications

Improve Availability and Flow of Information to Investors for IPO

- Modernize Securities Act Framework
- Many restrictions are vestiges of a paper-based world
- Release No. 33-8591 noted “substantial and unworkable restrictions”
- Opportune time to build on new approaches introduced in 2005

Goal: permit IPO candidates to communicate with investors while maintaining investor protection
The Solution: Improved Investor Communications

**Increase Supply**

**Improve Channel**

**Incent Demand**

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**Improve Availability and Flow of Information to Investors**

- Greater Role for Research During Capital Formation Process
  - Maintain principles & codes of conduct including separation of banking and research
  - Prominent disclosure regarding underwriter relationship
- Modifications to Banking Research
  - Expand existing research safe harbors
  - Permit broker-dealers to initiate coverage without being deemed to have “offered” IPO securities
  - Eliminate unnecessary quiet periods
  - Eliminate unnecessary restrictions on analyst communication
- Modifications to Company Disclosures
  - Permit confidential initial filings & review for U.S. issuers
  - Expand permissible pre-filing communications
    - Broaden “test the waters” provisions
    - Permit broader pre-filing investor communications
The Solution: Educate Issuers On Effective Use of Banking Channel to Build New Investor Base

**Increase Supply**

**Improve Channel**

**Incent Demand**

**Educate Issuers About the New Capital Markets Environment**

- Industry Participants, Not Policy Makers, Are Responsible For Education
- Help Emerging Growth Companies Become Better Consumers of Investment Banking Services
- Improved Education and Increased Involvement for Management and Board
  - Choice of Balanced Investment Banking Syndicate
  - Increase Issuer’s Role in IPO Allocation Process
  - Improve Practice of Investor Communications

**Goal**: To Reconnect Buyers and Sellers of Small Cap Stocks More Efficiently
The Solution: Demand Side Incentives

Increase Supply

Improve Channel

Incent Demand

Incent Buyers To Participate In IPOs

- Lower the Capital Gains Rate for Buyers of Newly Issued Stock if They Hold It for Two Years
- **Goal:** To Incentivize Investors to Participate in Emerging Growth IPOs
Appendix
Size Of Cohort That Qualifies For Regulatory “On Ramp”

“On Ramp” Impacts 15% of Companies and 3% of Total Market Capitalization

<table>
<thead>
<tr>
<th>For companies that went public in the previous 5 years</th>
<th>6/30/2011</th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
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<tbody>
<tr>
<td><strong>Number of Companies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Less than $1B revenue and IPO less than $700mm</td>
<td>556</td>
<td>558</td>
<td>571</td>
<td>732</td>
<td>777</td>
</tr>
<tr>
<td>as % of total public companies</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
<td>15%</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Total Market Capitalization at IPO</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than $1B revenue and IPO less than $700mm</td>
<td>$305</td>
<td>$288</td>
<td>$279</td>
<td>$338</td>
<td>$355</td>
</tr>
<tr>
<td>as % of total market capitalization</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Sources: Dealogic, Capital IQ, World Federation of Exchanges
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Advent of Electronic Trading</td>
</tr>
<tr>
<td>1999</td>
<td>Gramm-Leach-Bliley Overturns Separation Of Commercial &amp; Investment Banking</td>
</tr>
<tr>
<td>2001</td>
<td>Decimalization Introduced For all Exchange Traded Shares</td>
</tr>
<tr>
<td>2002</td>
<td>Sarbanes-Oxley Act</td>
</tr>
<tr>
<td>2002 – Today</td>
<td>Additional Accounting &amp; Compliance from Policy Makers &amp; Industry</td>
</tr>
<tr>
<td>2003</td>
<td>Global Analyst Settlement Separates Research &amp; Banking</td>
</tr>
<tr>
<td>2009 - Today</td>
<td>Dodd-Frank Act</td>
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</tbody>
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CEO Survey: IPOs Fuel Growth But Are Increasingly Difficult
Pre-IPO CEOs Target IPO To Finance Growth

Motivation for Pre-IPO Companies

- Cash to Support Future Growth: 63%
- Competitive Advantage from Being Public: 84%
- Premium Valuation from Being Public: 61%

Source: IPO Task Force August 2011 CEO Survey
Public Company CEO’s Most Significant IPO Challenges

Managing IPO Costs and Compliance Was Challenging

- Administrative Burden of Public Reporting: 92%
- Reallocation of CEO's Time to Reporting/Compliance vs. Co. Building: 91%
- Administrative Burden of Regulatory Compliance: 89%
- Managing Public Company Communications Restrictions: 88%

Source: IPO Task Force August 2011 CEO Survey
## Public Company CEOs: IPOs Are Important But Increasingly Difficult

<table>
<thead>
<tr>
<th>Statement</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
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<tbody>
<tr>
<td>Strong &amp; Accessible IPO Market Is Important to U.S. Economy &amp; Global Competitiveness</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>U.S. IPO Market Is Accessible for Small Companies</td>
<td>23%</td>
<td>11%</td>
<td>66%</td>
</tr>
<tr>
<td>It Is Not as Attractive an Option to Go Public Today as It Was in 1995</td>
<td>86%</td>
<td>3%</td>
<td>12%</td>
</tr>
<tr>
<td>Going Public Was a Relatively Painless Experience</td>
<td>17%</td>
<td>14%</td>
<td>69%</td>
</tr>
<tr>
<td>Going Public Has Been a Positive Event in My Company’s History</td>
<td>83%</td>
<td>14%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: IPO Task Force August 2011 CEO Survey

Value of IPO: 86% Growth In Employees
Rebuilding the IPO On-Ramp
Putting Emerging Companies, Investor and the Job Market
Back on the Road to Growth

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