



What to know before you conduct an IPO

An overview of the IPO process.
You only have one chance
to do this right.



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What is an IPO?

An Initial Public Offering, or IPO, is the process a private company takes to go public and have its stock traded on the open market.

IPO candidates may be highly-valued startups or well-established entities that have been operating successfully for years. In either case, a relatively small number of investors have had a stake in the company up to that point – the founders, perhaps a few family members and friends, as well as any venture capitalists or angel investors they were lucky enough to attract.

During the IPO, ownership of the company shifts overnight from these few investors to potentially thousands of shareholders. While the founders and managing executives usually retain enough shares to influence the direction of the company after the IPO, most major decisions from that point on must be approved by a board of directors elected by all shareholders. Once public, the company must allow shareholders to vote annually on routine and major items affecting the company.

Why go public?

Usually a company goes public because it's the best way to raise a large amount of capital needed to take the business to the next level. There are several additional reasons to conduct an IPO, including:

- Raises the public profile of company, which can increase sales
- Provides liquidity and/or an exit strategy for initial investors
- May qualify companies for lower interest rates on future loans due to the transparency of financials and stricter regulations placed on public companies
- Gives companies an option to use secondary stock offerings in place of cash to finance future mergers and acquisitions
- Attracts better talent with the incentive of employee stock purchase plans and equity compensation plans



Traditional IPO steps

An IPO is an intensely managed process that can take as long as a year or two to execute. Even after months of preparation and obtaining the necessary approvals, a company may postpone the actual event until market conditions are favorable. Favorable market conditions include low market volatility measured by the Volatility Index (VIX) valuation, favorable stock price movement and positive media coverage of a company's peer groups.

Below are the 16 basic steps that must be taken to carry out an IPO. Often several of these tasks may be happening at the same time.

Conduct an audit

The IPO process starts by choosing an advisory firm, usually a large accounting firm that specializes in IPOs. The advisory firm helps the company prepare its financial reports, which will determine if and when it qualifies for an IPO and on which exchange it qualifies.

Select the underwriting firm

Another major participant involved is the underwriter – a large investment bank that puts up the capital to underwrite the purchase and sale of the stock during the IPO. If the stock issue is too large for one firm to handle, the lead underwriter may choose to dilute the risk by inviting other investment firms to form a group known as a syndicate (made up of broker-dealers and investment bankers working together to provide a market for the security). In the months leading up to the IPO, the underwriter or syndicate works to raise capital and determine the best time to go public.

Select an exchange

In the U.S., there are two major exchanges, the New York Stock Exchange (NYSE) and NASDAQ, and many alternative trading markets. Each one has its own criteria to meet, including market cap, number of holders and board of directors' composition. Once the company selects the exchange on which it will be traded, the exchange will certify the company with the Securities and Exchange Commission (SEC) and announce to the public when the security will be admitted to trading. The exchanges issue their announcement a few days prior to the start of trading.



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Incorporation

While the audit is going on, the company's legal team, with the help of an outside law firm that specializes in IPOs, goes through the incorporation process, setting it up as a legal entity with headquarters in a chosen state. It must also comply with federal regulations and blue sky laws that may apply to public companies in each of the states in which it operates. International laws may also apply.

Blue sky laws are state laws designed to protect investors against securities fraud. They vary by state, but typically require companies and any sellers of its stock to disclose all financial details of the company so that investors have all the information they need to make investment decisions.

Appoint a board of directors

If the company doesn't already have a board in place, this needs to be done prior to the IPO. The board will need to establish the company's fiscal year, create bylaws, and authorize the issuance of stock and various other matters.

The company must have the majority of the board in place before they can obtain approval to list on an exchange.



Select a transfer agent

The transfer agent is responsible for getting the company's existing shareholder records in order, creating an official system of record and allocating the proper number of new shares to existing holders prior to the IPO. If the company wishes to conduct a pre-IPO stock split or reverse stock split, the transfer agent would handle this. These shareholders can then decide how many shares (if any) they want to sell as part of the initial offering.

The more mature the company and the larger its pre-IPO shareholder base, the earlier the transfer agent discussions should begin.

As startups known as unicorns (private companies valued over \$1 billion) become more common, their IPOs require careful handling. Transfer agents have expertise in securities and working with the bankers, relevant exchanges, and DTC. When companies utilize transfer agents early, they assist in avoiding any issues with getting the shares ready to be traded in the offering. As the IPO approaches, they ensure that everyone involved is on the same page down to the details.

File S-1 registration and preliminary prospectus

The company's outside counsel is responsible for preparing and filing the S-1 registration statement with the SEC. The S-1 is the filed prospectus of the company. Together, the S-1 registration and preliminary prospectus describe the company in detail, including its corporate name, business description, financial statements, structure, board of directors and the type of security offered. The final S-1 must have a price range and estimated number of shares to be sold.

A final prospectus that includes the specific details of the offering will be published closer to the date of the IPO. The S-1 must be deemed effective before the security can be admitted for trading. In addition to any updates to the preliminary prospectus, it will include an estimated price range for the stock and the number of shares the company plans to make public. The price range and number of shares will vary depending on the market conditions for the offering.

Regulatory approval process

The state of incorporation must approve the company's request for incorporation and the SEC must approve the S-1 registration filing. The regulatory department of either exchange (NYSE or NASDAQ) must also approve the company for listing. The company must adhere to the initial market cap requirement before being admitted to trading.

Prepare the stock and register the securities

Before the IPO, the company must decide how many classes of stock to issue and the rights assigned to each. For example, there may be one class for the public and another that is not publicly traded for founders and management. One class may have greater voting rights than the other, or may have no voting rights at all. A shareholder agreement must be drafted that outlines these details.

Then the stock must be registered via the S-1. In order for the S-1 to be deemed effective, it needs to be certified by a national exchange. The transfer agent has the oversight to make sure that there are enough shares in its possession to deliver at the close of the offering. The transfer agent manages restricted shares and allocates shares to all the entitled holders directed by the company.

In addition to the ticker symbol, each issue of stock must have its own Committee on Uniform Securities Identification Procedures (CUSIP) number – a nine-digit alphanumeric identification number that identifies the company and the particular issue. The transfer agent allocates new shares to the existing (registered) holders before the IPO, while the syndicate looks to sell shares to new investors (beneficial holders) during the IPO.



Conduct stock split

Once the transfer agent has all the private investors' pre-IPO positions registered, the company may wish to conduct a stock split or reverse stock split prior to the IPO. This helps the company and underwriters arrive at a target price per share, as well as the number of shares the company will be putting into the IPO. The transfer agent manages this process.

Announce the IPO

Once SEC registration becomes effective, the underwriters must determine the best time to conduct the IPO. Usually this announcement is made a few weeks in advance to give all parties time to prepare. The relevant exchange performs various functions on behalf of the company going public, including announcing the IPO to its members and delivering IPO information to the public. The information must include the tentative listing date for the IPO. The syndicate works with the lead underwriter who will act as the "book builder" (which includes the process of supporting the share price by buying shares below a certain price level and entering orders into the trading system providing liquidity when the security begins to trade). This lead underwriter is also known as the stabilization agent.

Road show

To generate interest and excitement among investors, the company will often go on a road show, pitching its value to large institutional investors. These are highly publicized events and usually the most publicly visible step of the IPO process.

Price the offering

About a week before the IPO, the syndicate members reach out to their internal network of institutional investors and high-net-worth individuals to determine how many shares they'd be willing to buy and at what price. The lead underwriter then creates the series of books detailing which investors will buy or sell at any given price. The ultimate goal is to arrive at a price and exact number of shares that will satisfy the company with the desired amount of capital.

Once this is accomplished, they have "priced the offering." An agreement is signed by the syndicate members and the company. The syndicate has essentially just purchased all of the IPO-designated shares at the agreed-upon price, though no money has changed hands yet.

The lead underwriter calls up the relevant exchange and the IPO is set for the following day, with the offering price listed as the pre-IPO "closing price."

The IPO

A ringing bell marks the opening of the exchange on the offering day. Usually a few representatives from the company's management team are invited to do the honors. The lead underwriter manages the trading process. The price fluctuates, sometimes quite a bit, but the goal is to sell the shares as close as possible to the offering price. The lead underwriter may bring in greenshoe shares, if available, or buy back shares to keep the price somewhat stable throughout the process.

Also known as an overallotment option, a greenshoe option is an option written into the underwriting agreement that allows the underwriter to buy additional shares from the company if demand is higher than expected. By issuing more shares into the IPO, they can keep the price per share closer to the target offering price.

SEC regulations governing IPOs allow companies to issue a maximum of 15% more shares than originally planned and hold them in reserve. The underwriter has up to 30 days from the offering to exercise these options. Greenshoe options that are not exercised will be held by the company in reserve for another purpose, such as a secondary offering.

The closing

After the closing bell, the syndicate members and transfer agent have two days to clear the transactions that have just occurred. The syndicate members collect from their investors and pay the company the agreed-upon price per share, minus their fees. The transfer agent delivers shares directly to registered shareholders and to brokers through the Depository Trust Company (DTC), giving each a statement that details their new position in the company. The IPO is officially closed.



Public float

The day after the closing, the shares are now in the public float or “secondary market,” where anyone can trade them. Insiders (founders and early investors who own 5% or more of the company’s stock) are often subjected to lock-up agreements that prevent them from selling additional shares for a designated time period after the IPO. This allows the market price to stabilize before being flooded by an influx of new shares.

During an IPO, it’s common for the underwriters to require company insiders and investors to sign lock-up agreements that prohibit them from selling any additional shares for a certain period of time beyond the shares allotted for the IPO. Lock-up agreements were established to create a period of stability in the stock price, allowing it to reach its own level after the excitement of the IPO dies down.

Once the lock-up period expires, the insiders can sell their stock. This sudden influx of new shares often causes a drop in price, which may be temporary or may signal that the shares were overpriced. In this case, the lock-out period serves to protect the underwriters, giving them some time to sell their shares.

According to SEC Rule 144, 90 days is the minimum period for a lock-up agreement, but the underwriters can specify a time period of up to two years. Lock-up agreements may also be required under certain states’ blue sky laws. If an IPO includes a lock-up agreement, details must be listed in the company prospectus.



Other types of IPOs

Regulation A+ IPO

A Regulation A+ (Reg A+) IPO is a capital-raising option for smaller, early-stage private companies that cannot attract the attention of huge institutional investors or afford the high costs of a traditional IPO. Companies going public under Reg A+ face fewer regulatory hurdles and expenses, and may offer shares to the general public – not just huge investment banks and high-wealth individuals. These types of IPOs may be suited for certain types of smaller companies with a large and loyal customer base.

An update to the 2012 JOBS Act separated the offerings into two tiers, with different rules applied to each:



Tier 1

- Up to **\$20 million** may be raised in a 12-month period
- No more than **\$6 million** in shares may be offered to **security holders** who are affiliates of the issuer (**early investors**)
- **Subject** to federal and state registration and qualification requirements

Tier 2

- Up to **\$50 million** may be raised in a 12-month period
- No more than **\$15 million** in shares may be offered **selling to security holders** who are affiliates of the issuer
- **Not subject** to federal and state registration and qualification requirements

How Reg A+ differs from a traditional IPO

- Limited to a certain amount of capital that can be raised in a 12-month period
- Marketed to the general public
- Tier 2 offerings are not securities being sold, not registered with the SEC nor subject to state securities laws
- Lower legal and filing fees
- Stock may be offered without being listed on an exchange
- Companies can privately submit a draft offering memorandum to the SEC for review prior to the final version
- Tier 2 offerings can be tested on an exchange, a process known as a mini-IPO
- Streamlined SEC review process
- Non-accredited investors (who do not meet certain SEC income requirements) may participate
- Combine public solicitation of shares with private funds from venture capitalists to raise more capital

How Reg A+ is similar to a traditional IPO

- Requires a team of experts including an independent auditing firm, legal team, transfer agent and underwriter(s)
- A final offering memorandum must be filed publicly and approved by the SEC for distribution to participants
- Companies must raise enough capital to meet the minimum requirements of the exchange on which it is listed
- Must comply with all rules and regulations that apply to listed companies and securities, including SEC reporting, tax reporting and shareholder communications
- Up to 30% of the shares sold can come from founders or early investors, offering these investors liquidity and an exit strategy
- Access to liquidity through secondary sales. The SEC now allows secondary offerings to be sold via a Reg A+ plus offering. Reg A+ also allows issuers to create liquidity by including shares held by selling security in the offering.

SPACs and reverse mergers

A Special Purpose Acquisition Company (SPAC) is a publicly-traded company designed to acquire a targeted business segment or specific company. If it does not achieve its goal within a specific timeframe, the SPAC will be dissolved and the funds provided will be returned to investors. Some activities of a SPAC are similar to a reverse merger. However, SPACs can raise significantly more money than reverse mergers at the time of their IPO. SPACs also offer an attractive, liquid investment available on the open market. In addition, many investors prefer SPAC acquisitions to reverse mergers due to lower risk – the management of the target company remains, but the SPAC management may take seats on the board of directors of the new combined company.

Once the private company and SPAC merge, they create an entirely new public company. Shares in the private company are then swapped for shares in the public company, according to the terms of the merger agreement. No additional shares are issued or funds are raised. The private company's shareholders and management team retain control of their assets and now control the public company.

In this way, the company gains all the benefits of publicly traded stock, without the time, expense and public scrutiny of an IPO. Early investors benefit from greater liquidity, and the company benefits from being able to use stock as a currency for future acquisitions.

If a mature private company wants to enjoy the benefits of publicly traded stock, a reverse merger can be a quick and cost-effective way to go public. Also called a reverse takeover or reverse IPO, a reverse merger is the acquisition of a small publicly traded company by a much larger private company. It's called a reverse merger because the smaller company and its stock survive, while the larger company no longer exists.



How reverse mergers differ from an IPO:

- Two companies are involved and must agree to the arrangement
- No capital is raised; the private company merges with the public company and new shares are allocated for the shareholders of both companies
- The process is not dependent on market conditions
- The process can be completed in as little as one month
- It does not require an underwriter
- There is less stock dilution than with an IPO

How reverse mergers are similar to an IPO:

- Regulatory approvals must be obtained (from the SEC, relevant state jurisdictions, etc.) for a reverse merger, but it's a much quicker process than an IPO
- The transaction requires the services of a transfer agent and a legal team
- Management of the private company retains control of the company and its assets
- Offers founders and investors in the private company liquidity and/or an exit strategy
- The newly merged company enjoys the same benefits of a newly listed company
- The newly merged company is also subject to the same regulations and requirements as a newly listed company

After the IPO

While IPOs are extraordinarily exciting for the companies and shareholders involved, it is only the beginning. Private companies haven't had to deal with shareholders and all the regulations and requirements that govern the offering, ownership and trading of securities. That's where transfer agents shine.

While any transfer agent can handle an IPO and operates under the same regulations, the transfer agent's job does not end on closing day. In fact, it is just the beginning.

Companies preparing for an IPO should be aware that the transfer agent they choose will be their long-term partner, managing shareholder services, helping with investor relations, providing expertise for corporate actions and ensuring regulatory compliance from that day forward.



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