

25 Considerations in Preparing for an IPO

1. **ADVISORS.** Choose experienced advisors early, including attorneys and auditors. Experienced advisors will expedite the process and help avoid glitches and delays in your SEC review. Speed matters. Execution is critical.
2. **UNDERWRITERS.** Identify prospective investment bankers and leading analysts in your market space. Consider the appropriate number and mix of managing underwriting firms and which ones can “get the deal sold” if market conditions turn against you.
3. **AUDITED FINANCIAL STATEMENTS.** Make sure your audited financial statements are close to final. You will generally need three full years of audited financial statements in your SEC filings. If you have switched auditors during that period, consult with both firms, as your current firm may need to re-audit prior years.
4. **OTHER FINANCIAL STATEMENTS.** Consider when your quarterly interim financial statements will become available and understand the impact this will have on the timing of your SEC filings. Make sure you are in a position to assemble five years of “selected” financial data (unless you have been in business for a shorter period). If you have undertaken acquisitions or other significant transactions, understand what additional financial statements may be required in your filing, including pro forma financial statements and separate audited financial statements related to the acquired businesses.
5. **ACCOUNTING ISSUES.** Identify any sensitive issues in your significant accounting policies. Discuss these with your audit team and make sure they discuss them with their “national office”. The SEC’s “hot issues” are constantly evolving, often unpredictably and without formal notice.
6. **CHEAP STOCK.** One SEC hot issue that won’t change is the “cheap stock” analysis—whether sufficient charges have been taken in the past for stock options and other equity grants. This issue has become more critical as the IRS has announced it will be targeting companies with cheap stock charges disclosed in their SEC filings for Section 409A enforcement. Work closely with your auditors and counsel to analyze this issue. Do this early.
7. **STOCK VALUATIONS.** If you haven’t already done so, engage an independent valuation expert to perform regular stock valuations to help you price option grants going forward. Many pre-IPO companies perform valuations on a quarterly basis, if not more often, depending on their option granting schedule. Consult with your valuation expert regarding their willingness to consent to being named in your SEC filings.
8. **WHICH STOCK EXCHANGE?** Understand the benefits of the alternative stock exchanges—NYSE, Nasdaq, NYSE Alternext (formerly the American Stock Exchange) or even AIM in London. Analyze the listing standards of your preferred market to ensure you will qualify to list there.

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9. **BOARD AND COMMITTEES.** Reassess the composition of your board of directors and board committees to identify any changes necessary to satisfy exchange listing requirements and SEC requirements. Understand the requirements for independent directors and the transition rules that will apply after your IPO.
10. **CORPORATE GOVERNANCE.** Begin to act like a public company. Focus on corporate governance appropriate for a public company and develop a culture of compliance. Work with counsel to adopt state-of-the-art corporate policies and codes of conduct.
11. **MANAGEMENT TEAM.** Build out your senior management team, as necessary, to operate as a public company.
12. **EXECUTIVE COMPENSATION.** Consider engaging a compensation consultant to assist in analyzing compensation practices, including equity and non-equity incentives. Begin to develop a compensation structure appropriate for a public company. And remember that the reasons for your executive compensation decisions must be disclosed publicly in your SEC filings.
13. **INTERNAL FINANCIAL CONTROLS.** Discuss with your advisors any “material weaknesses” or “significant deficiencies” in your internal financial controls and understand their impact on your SEC review. Be prepared to discuss these forthrightly with your underwriters and to disclose them publicly.
14. **SOX COMPLIANCE.** Understand the transition period over which you will need to become compliant with the internal controls testing required by Section 404 of the Sarbanes-Oxley Act. Consider engaging an accounting consultancy firm now to assist with compliance.
15. **AUDITORS.** Ensure that your audit firm is properly “independent” from your company under PCAOB and SEC rules. Don’t hire employees of your audit firm without first understanding whether that will compromise the firm’s independence. Understand what relationships there may be between your auditors and your officers and directors, including whether the firm has provided any tax services to your officers.
16. **PUBLIC COMMUNICATIONS.** Discuss with counsel the rules that will govern your public communications during the IPO process. Standardize public communications to establish a track record, and develop consistent processes for external communications, including review of press releases by outside counsel. Beware of media interviews and public appearances, including industry or analyst conferences.
17. **CORPORATE WEBSITE.** Perform a review of your company’s website to ensure that the information on the website is accurate and current. Work with counsel to make sure that the website is consistent with SEC positions on acceptable public communications prior to an IPO and permissible website content.
18. **CORPORATE DOCUMENTS.** Understand the provisions of your current charter, bylaws and other corporate documents as they relate to an IPO. Who has registration rights? Are any special approvals required from stockholders or third parties? Will your preferred stock automatically convert? Are all stockholders and optionholders required to sign 180-day “lock up” agreements with your underwriters? Make sure that your capitalization records accurately reflect all stock issuances, transfers and cancellations, as well as option and warrant issuances, exercises and cancellations.
19. **STATE OF INCORPORATION.** If you are not already a Delaware corporation, consider whether you should be.

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20. **DUE DILIGENCE.** The underwriters in an IPO and their counsel will conduct extensive due diligence on your company, including a thorough review of its minute books, capitalization records, material agreements, etc. Anticipate what materials the underwriters and their counsel will want to review, and begin organizing these documents to expedite the due diligence process. Failure to do so could result in avoidable delays to your offering. Consider engaging an online datasite firm for the delivery of due diligence materials, and get materials posted early. As part of your due diligence process, work with counsel to analyze your historic option grants to ensure they have complied with Rule 701 of the Securities Act.
21. **LEGAL DISPUTES.** Analyze any pending or threatened legal disputes and assess whether any of these disputes could potentially derail the IPO. Also consider the impact that filing for an IPO may have on your negotiating position in these disputes. Litigants will often be less likely to settle for a reasonable amount if they know the company is in the IPO process. If you are thinking of initiating a dispute with another party, consider its effect on the IPO.
22. **CONFIDENTIAL TREATMENT.** SEC rules will require you to publicly file material commercial agreements. Determine which agreements will likely be required to be filed and review these agreements for confidentiality provisions that will need to be waived by the counterparty. Also, determine which terms, if any, of these agreements, would be competitively harmful if disclosed. Discuss with your counsel the process of seeking confidential treatment from the SEC for these provisions.
23. **DIRECTOR & OFFICER LIABILITY INSURANCE.** The exposure to liability is significantly greater for directors and officers of public companies than it is for private companies. A private company D&O insurance policy will not be appropriate once the company is public. Choose an experienced D&O insurance broker and coordinate with the broker early in the process to ensure that your officers and directors are adequately protected.
24. **PERSONAL FINANCIAL PLANNING FOR EXECUTIVES.** Senior management should consult with personal financial advisors regarding wealth maximization alternatives. Bear in mind that any loans from the company to executives or directors must be repaid before your first filing with the SEC.
25. **PERHAPS MOST IMPORTANT—DO YOU REALLY WANT TO BE PUBLIC?** Carefully consider the implications of becoming a public company and the alternatives. Are you ready for the management distraction that will be involved in the IPO process? Are you prepared for the potential liabilities, the requirement for transparency and full disclosure, and the short-term focus that will be adopted by the analysts who follow your stock? Is your financial team ready to produce quarterly financial statements in the required time frame? Do you have adequate visibility into your future financial results and do you have a financial model that promotes predictability? Are your insiders ready to relinquish control and answer to new public stockholders?

This fact sheet is intended as a general introduction to the transaction process and is not intended to provide legal advice as to any specific transaction; it will not be deemed to create an attorney/client relationship between Cooley Godward Kronish LLP and the reader and you may not rely upon any of the statements contained herein for purposes of any specific transaction. Each transaction is unique, and will involve complex legal issues that can only be properly analyzed by an attorney who is retained by you to provide you with legal advice specific to the facts and circumstances pertaining to that transaction.

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