



Going public: A guide for owners

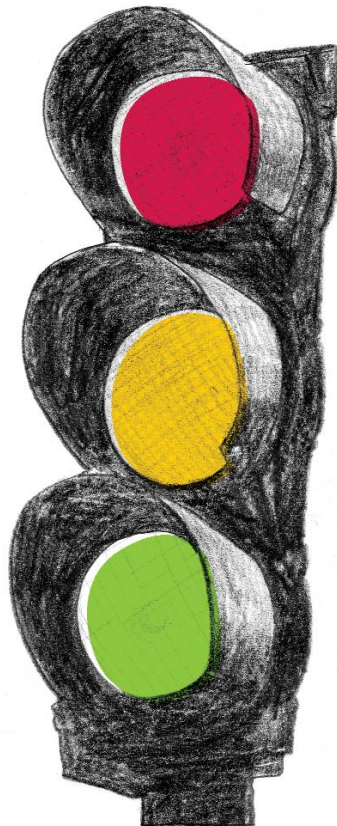


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Overview

Perhaps you are the principal owner of a flourishing company that needs additional funds to finance expansion, de-leverage the balance sheet or facilitate the acquisition of another company. Or perhaps you would like to take advantage of some of your equity in the company, transfer family wealth or enable your family to pay estate taxes while they continue to control the company you have built. Taking your company public with an initial public offering (IPO) may be the best way for you to accomplish your goals.

Going public is a major milestone in the life of your company, as well as a major transition. In going public, you give others a chance to invest in your business and to share in its market potential. However, doing so requires many changes in the way you manage your company.

You will encounter different and more frequent reporting requirements for investors and regulatory agencies. Your announcements and press releases will generate greater visibility and attention. And, above all, there are high expectations — from shareholders, boards of directors, regulatory agencies, media, investment bankers, stock exchanges, management and employees.

Many successful IPOs have involved companies with experienced and committed management, who demonstrated a solid business history, proven products, significant assets, strong earnings and the potential for further growth. During the Internet boom of the late 1990s, many companies with little or no track record successfully went public; many subsequently failed due to such factors as poor

business models, inability to keep up with advances in technology and lack of revenue growth. As a result, today markets and investors are focusing on the more traditional approach in determining whether companies make promising investment opportunities.

Going public is not a sure thing. Since many factors contribute to the success of an IPO, it must be carefully planned. Additionally, with the enactment of the Sarbanes-Oxley Act of 2002 came increased federal regulation of public company reporting and corporate governance, which has significantly increased the effort and cost associated with becoming public. An IPO may still be the best way for you to accomplish your goals, but careful consideration of the alternatives should also be part of your planning process.

If you are thinking of taking your company public, this guide may help you determine whether an IPO would suit your business strategy and personal needs. If you have already decided to go public, it will guide you as to what you may have to do. *Going Public* discusses:

- The major advantages and disadvantages of going public
- The professionals you need to consult and the type of assistance they provide
- The key steps in dealing with underwriters
- The steps of the public offering process

This guide will provide you with a clear overview of the IPO process and will help you anticipate issues before they occur.

Pros and cons of going public



The decision to go public is momentous. Although going public has many potential benefits, disadvantages also exist. Because the IPO process is costly, time-consuming and difficult, you may want to first consider other sources of capital or alternatives to an IPO, such as long-term debt financing, private equity or debt placements, joint ventures or even the sale of the company. There are pros and cons to these other alternatives as well. After reviewing the various options, you should discuss the matter with your outside advisers, including your accountants, attorneys and other professionals. If you decide to proceed with the IPO, you will want to plan for the organizational changes that will occur during and after the offering.

Why go public?

Raise capital

Offers a source of funding when growth cannot be financed by cash flow, private equity or debt financing.

Provide liquidity for original stockholders

Enables original stockholders to monetize their holdings or diversify their personal investments.

Simplify estate planning

Selling stock can cover estate tax liabilities.

Acquire currency for the future

Provides the resources to finance other acquisitions.

Create a higher company profile

Increased visibility can lead to additional opportunities.

Provide incentives for employees

Equity stakes can attract, retain and motivate quality personnel.

Reasons for going public

Taking your company public can help you accomplish a number of objectives. The net proceeds can be used to invest in the growth of the company, pay off debt or provide liquidity for the existing shareholders. Consequently, you may wish to go public to benefit either the company or yourself, objectives that are not always mutually exclusive and may frequently overlap.

The benefits of an IPO to the *company* are outlined below.

Additional capital. Your company may be able to raise substantially more capital by going public than it can raise through other means, such as debt financing or private sources.

Future equity or borrowings. A public offering may increase your company's net worth and debt-to-equity ratio, which can improve its ability to borrow or raise capital in the future. If your company's stock performs well in the public market, it will be able to sell additional shares on favorable terms.

Currency for the future. The stock of a public company can be used as currency to finance future acquisitions — a consideration that can be important if your long-term strategy includes plans for diversification, geographic expansion or other strategic ventures.

Company stature, prestige and visibility. A public market for your company's stock can increase its prestige and market recognition, which can generate more interest from customers, suppliers and business associates. This can frequently lead to additional business opportunities that might not materialize if the company remains privately held.

Means of attracting and retaining quality personnel. A company with publicly traded stock has a powerful tool to attract and retain quality personnel. You can offer company shares or options to purchase these shares as compensation or incentives. Employees with an equity interest in the company often have a strong incentive to act in its best interests.

The benefits of an IPO to *owners* are outlined below.

Stockholder liquidity or wealth. Company stockholders may be able to liquidate a portion of their holdings to diversify personal investments while keeping the company on sound financial footing. There are limitations as to how many shares can be liquidated in the initial offering, as well as blackout periods for selling shares. It is important to discuss these matters with the company's attorney to understand the limitations.

Estate planning. A public company can be an important estate planning tool for owners. Heirs will be able to sell stock to cover the cost of estate taxes and, in many instances, to do so while retaining sufficient shares to maintain control of the company. Note, though, that the estate tax valuation is usually higher when the company is public because the shares are more liquid and more easily valued.

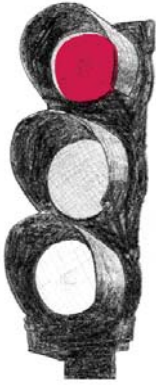
Personal prestige. Owners can gain a great deal of personal prestige and a sense of self-fulfillment from being the head of a public company. Going public is a measure of success, which can provide a source of personal pride for an owner.

Reasons for staying private

There are a number of reasons why you may wish your company to remain private. These are outlined in the sections below.

Disclosure of information. A public company's operations and financial results are open to public scrutiny. As a result, information about the company, its officers, directors and certain shareholders, which is not ordinarily disclosed by privately held companies, will now be available to competitors, customers, employees and others.

Information such as your company's sales and profits, your competitive advantages and strategies and the salaries and perquisites of your officers and directors must be disclosed not only when you initially go public, but also periodically after the offering is completed.



Reasons for staying private

Additional financial disclosure

There are increased requirements for sharing information with investors and for reporting to the SEC.

Time requirements

Organizing information, developing materials and meetings consume large amounts of time. Additionally, upper-level management needs to be more involved with the compliance aspects of being a public company.

Possible loss of control

Original owner(s) may no longer retain a controlling interest.

Investor pressure for short-term results

Emphasis on short-term profitability can result in stock price volatility.

Cost

Underwriters' commission is typically 7 percent, and there are other significant out-of-pocket expenses.

Increased recurring costs

Being public triggers additional ongoing costs of preparing, filing and distributing quarterly and annual reports and proxy material, as well as fees for transfer agent and public relations.

Public company reporting

Your company will be subject to the federal securities laws and will be required to comply with the reporting requirements of being a public company.

Time demands. The process of going public will require a great deal of time from both you and your management. You will need to meet frequently with the underwriters, lawyers and accountants and spend many hours assembling financial and operating information about your company. You must also become actively involved in selling your deal to the investment community. Overall, a typical IPO takes four to five months to complete and will consume much of your time during that period. Finally, you and your executive team will spend a significant amount of time working on the compliance aspects of being a public company, time that might otherwise be spent on activities that are core to the business itself, such as sales and customer relations.

Possible loss of control. If a sufficiently large percentage of the company's shares is sold to the public, you may lose control of the company. Ownership dilution may also result from any subsequent equity offerings, stock option and warrant exercises or acquisitions of other companies for stock.

Investor pressures. You may be under considerable pressure to maintain the company's performance. And, because you will be reporting operating results quarterly, many individuals, such as investment bankers and shareholders, will be evaluating the company on this basis. This could shorten your planning and operating horizons and generate pressure for short-term profitability, possibly at the expense of your long-term goals.

Cost of an IPO. An IPO is expensive. The underwriters' commission is typically 7 percent of the total offering proceeds. In addition, there are substantial out-of-pocket expenses, including fees paid to attorneys, accountants and printers. These out-of-pocket costs vary based on the complexity of the issues, market delays and other factors. There is a risk that an IPO will not be consummated and will fail to recover out-of-pocket expenses.

Increased recurring costs. In addition to the expenses associated with going public, there are significant costs that come with being a public company. Your company will incur costs related to establishing and maintaining the corporate governance and internal control structures that are required of public companies, as well as costs for building an accounting and finance organization familiar with the requirements and complexities of being a public company. You will also incur costs related to complying with the federal securities laws, while legal and accounting fees can increase significantly. Additionally, the company will incur costs for preparing, filing and distributing proxy materials and reports to shareholders and fees for a transfer agent, a registrar and a public relations consultant.

The company will also need to compensate independent directors and pay premiums for directors and officers' liability insurance. In a litigious environment, a public company and its officers and directors are vulnerable to lawsuits alleging violations of securities laws. Even for claims without merit, defending against these actions can be time consuming and expensive.

Public company reporting. You will be subject to all of the federal securities laws once your company becomes a public company. You should discuss your responsibilities and obligations under these laws with your legal counsel. Certain of the compliance requirements are as follows:

Periodic requirements - Your company will be required to file periodic reports on an ongoing basis with the Securities and Exchange Commission (SEC). Your company must file an annual report, which among other things must include the latest audited annual financial statements, information about the business and management's discussion and analysis of the company's financial condition and results of operation (MD&A). Every quarter, your company must also file a quarterly report. This report must include, among other things,

quarterly financial statements that must be reviewed by your independent public accounting firm before filing, management's discussion and analysis and disclosures of specific reportable events that may have occurred during the quarter. Your company must also file current reports between the quarterly and annual reporting periods if a reportable event occurs. Reportable events include such events as the acquisition or disposition of assets, entry into or termination of a material definitive agreement, changes in control of the company and departure of directors or principal officers. These current reports must be filed on Form 8-K within four business days of the event.

Sarbanes-Oxley Act of 2002 - In July 2002, Congress enacted the Sarbanes-Oxley Act of 2002 (Sarbanes), aimed at strengthening corporate governance and restoring investor confidence. There are significant changes in public company reporting that have resulted from Sarbanes, including CEO and CFO certifications on the effectiveness of specified internal controls over corporate reporting, auditor attestation of the effectiveness of certain companies' internal controls over financial reporting and other enhanced corporate governance initiatives. There is also an increased cost to a public company to comply with Sarbanes and an increased level of involvement for upper-level management.

Exchange listing requirements - Your company will be required to meet the continued listing standards of the exchange on which your company's stock is listed. These standards include quantitative and corporate governance standards, and they vary among each of the exchanges.

Regulatory environment and financial reporting issues

The SEC is the primary regulatory body that oversees the offering and trading of securities. Its objectives are the protection of investors and the maintenance of fair and orderly markets. The SEC's role is to protect the investing public, not the issuer or the underwriters. The SEC was created by the Securities Exchange Act of 1934. It is responsible for administering the provisions of that Act, as well as the Securities Act of 1933.

Securities Act of 1933

The Securities Act of 1933 (the 1933 Act) requires registration of securities with the SEC before their sale to the public. The 1933 Act relates principally to disclosure at the time of sale and distribution of securities, and has two main objectives: (1) requires that investors receive financial and other significant information concerning the securities being offered for sale, and (2) prohibits misrepresentation, deceit and other fraud in the sale of those securities.

Securities Exchange Act of 1934

The Securities Exchange Act of 1934 (the 1934 Act) deals principally with keeping investors informed on a continuing basis about the issuer's financial status and actions. This is accomplished by requiring issuers to file annual, quarterly and other periodic reports. The 1934 Act also covers regulation of stock exchanges, broker-dealers and other matters, including registration of an issuer's securities when they are to be traded on an exchange or in the over-the-counter market.

Sarbanes-Oxley Act of 2002

As a private company, you want to consider the requirements for full compliance with Sarbanes before commencing the offering process. Sarbanes instituted significant reforms for the U.S. financial reporting system, including the following:

- Creation of the Public Company Accounting Oversight Board (PCAOB) to oversee accounting firms that audit the financial statements of public reporting companies
- New rules with respect to auditor independence
- New rules regarding members of the audit committee
- Requirement for CEO and CFO certifications in quarterly and annual reports
- Additional disclosures in filings made with the SEC
- Documentation of a code of ethics for senior financial officers
- Requirement to establish a whistleblower policy
- Acceleration of filing deadlines for quarterly and annual reports

Before commencing the offering process, you want to have a plan in place to address the following:

Board of directors. Sarbanes requires that the board of directors be composed of at least a majority of independent directors. This requirement may call for you to significantly alter the structure of your company's board of directors. Because of heightened concern over the potential personal liability, as well as a shift from equity to cash compensation, attracting and retaining board members has become more difficult and more expensive. You should plan for a substantial amount of time and effort to identify and recruit qualified independent directors.

Audit committee. Sarbanes requires all members of the audit committee to be independent and to meet basic financial literacy requirements. At least one member must meet the definition of a "financial expert," namely, an individual with:

- (1) An understanding of generally accepted accounting principles and financial statements
- (2) The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves
- (3) Experience preparing, auditing, analyzing or evaluating financial statements that present a wide range and level of complex issues that could reasonably be raised by the issuer's financial statements, or experience actively supervising one or more persons engaged in such activities
- (4) An understanding of internal controls over financial reporting
- (5) An understanding of the audit committee functions

The audit committee's primary responsibility is to provide independent review and oversight of the company's financial reporting process, internal controls and independent auditors. This includes appointing the auditor and pre-approving any services (audit, audit-related and permitted non-audit services) provided by the auditor and its affiliates. An audit committee needs a charter that outlines its responsibilities.

Relationship with auditor. The SEC's independence rules prohibit a company's external auditor from providing non-audit services to an audit client or its affiliates if the auditing firm will be:

- Auditing its own work, such as providing bookkeeping or accounting services, assisting in designing or installing information technology systems for the accounting function, conducting appraisals or valuations, providing internal audit services or performing actuarial functions
- Performing management functions, such as developing strategic plans or forecasts or recruiting personnel
- Acting as an advocate, such as providing legal or corporate board services or expert services in litigation
- Developing a mutuality of interest with company management, such as performing services that are incompatible with independence (broker-dealer, corporate finance, or investment banking services), joint marketing or certain business arrangements, or entering into a fee arrangement contingent on achieving certain results

You should plan for a substantial amount of time and effort to identify and recruit qualified independent directors.

The recently enacted PCAOB independence rules prohibit your external auditors from providing tax compliance or consulting services that involve listed transactions, such as tax shelters, or recommendations on tax structuring that does not have a greater than 50 percent chance of being sustainable on examination by a taxing authority. After your company makes the determination to begin the IPO process, the PCAOB independence rules also prohibit the auditing firm from continuing to provide tax consulting and compliance services to the company's officers and directors or their family members.

Although the SEC permits certain limited exceptions for smaller accounting firms, it requires that the lead, concurring and other audit partners assigned to your company periodically rotate off the audit engagement. For example, the lead and concurring partners are limited to working on the audit engagements for five years and then must be off the engagement for five years. This provides a fresh look at the company's financial statements and its internal controls over financial reporting.

You should evaluate your company's existing relationship with your outside auditor to identify any services that are not permitted by Sarbanes for each of the years included in the IPO. Furthermore, the external auditor must be independent for all years for which financial statements are included in the offering document.

Loans to company executives. Sarbanes prohibits publicly traded companies from providing certain personal loans to directors and executive officers. Companies should work with their attorneys to determine which loans are prohibited and take appropriate corrective actions before the offering.

Code of ethics. To enhance corporate governance, Sarbanes requires public companies to either establish a code of ethics or disclose the reason for not establishing one.

Internal controls. Sarbanes requires the CEO and CFO to certify in periodic filings with the SEC the accuracy of the financial statements and the effectiveness of the company's internal controls over financial reporting. The outside auditor is required to audit certain companies' internal controls over financial reporting on an annual basis. There are phased-in compliance dates for these requirements for certain smaller company filers. Companies in the IPO process and newly public companies are not required to provide either a management assessment or an auditor attestation report until they file their second annual report with the SEC.

While companies in the IPO process are not required to comply with these regulations, in order to prepare for these certifications and audit, it is important to establish, document and monitor compliance of internal controls as early as possible.

You should evaluate your company's existing relationship with your outside auditor to identify any services that are not permitted by Sarbanes for each of the years included in the IPO.

Accounting and disclosure issues

In recent years, a number of standards have been issued or are receiving increased focus by the standard-setting bodies and the SEC. The following areas may be particularly troublesome:

Revenue recognition. In part because of the complex revenue-generating arrangements that exist in the market, the SEC has increased its focus on companies' revenue recognition practices. Some of the areas that are more difficult for companies to address are revenue arrangements with multiple deliverables, bill and hold transactions, recognition of up-front fees, software revenue recognition and service contracts.

Segment reporting. A significant focus of the SEC is whether companies have appropriately identified their business segments and whether their segment disclosures are adequate. The SEC continues to find issues with inappropriate aggregation of multiple segments.

Consolidation issues. In response to issues related to accounting for special purpose entities, the standard-setters issued guidance that changes the criteria to consider when determining whether to consolidate an entity. Considerations such as the risks and rewards of ownership must be addressed before considering voting interests.

Compensation issues - cheap stock. Granting stock options shortly before an IPO may create a compensation charge issue due to the SEC's rules on cheap stock. The SEC will closely scrutinize those circumstances in which option prices are significantly less than the IPO price and may challenge that the exercise price was below market value at the time of grant.

In preparing for an IPO, you should review your option pricing history in order to address this issue before the initial filing with the SEC. The SEC encourages companies to obtain independent valuations from competent professionals contemporaneous with the issuance of the stock options.

Stock options and other forms of stock-based compensation. In response to demands from investors and others to improve the accounting for share-based payment arrangements with employees, the standard-setters issued guidance that requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. This requirement represents a significant change in practice for most companies.

Senior management should consider the financial accounting, income tax and internal control implications of the new standard, as well as review the company's stock-based compensation plans to ensure that those plans reflect a reasonable cost-benefit relationship.

Additionally, you should be prepared to comply with the SEC's rules relating to the use of non-GAAP (generally accepted accounting principles) financial measures, critical accounting policies and off-balance sheet arrangements.

Preparing for the initial offering

To complete an IPO, you need to do extensive planning. A great deal of preliminary work is required, and some steps can take a considerable amount of time to execute.

Timing

The timing of your offering is one of the most important considerations. To obtain the best price for your shares, market conditions must be favorable, and your company should be attractive to investors. Among the questions to ask regarding IPO timing are:

- Is the general climate for IPOs favorable at this time?
- Is your industry “in favor” with the investment community?
- Is the market potentially saturated with similar companies from previous IPOs?
- What is the general risk tolerance of the market?

Operating considerations

You cannot influence the market conditions, but you can assess the attractiveness of your company’s stock.

Ideally, your company should have attained a reasonable size, profitability and growth to make it an attractive investment compared with others in your industry and those in other industries. Most important, there must be the prospect of continuing growth. Other types of companies that can be attractive include the following:

- Companies that have a long and continuous record of strong sales and earnings. They may not be nationally known, but they offer a good long-term investment at a reasonable price-to-earnings ratio.
- Early-stage companies that have yet to show a profit, but that have outstanding potential. Typically, the market looks for companies in industries that can support significant growth with cutting-edge products and an experienced management team. These companies usually go public after reaching a point in their development when most of their technological, manufacturing and marketing risks have been substantially reduced.

If your company does not fall within these categories, you should probably explore other forms of financing before pursuing a public offering. Your investment bankers are best able to advise you about how the market may view your company and the most favorable timing.

Certain operating characteristics can enhance your company’s appeal to investment bankers, who look at the following factors in addition to financial performance and future prospects:

Innovation. To attract investors, a company needs a product or idea that is leading edge and, in many cases, provides a solid revenue stream. Whether it is new technology or enhancement of an existing idea, the investing public needs to view the company as having a good chance for future success.

Market potential. The company's product should have a market that will support consistent growth.

Management team. The quality of the management team is very important. Top management must have the ability to cope with the challenges of anticipated growth and be able to maintain the company's direction. Having some executives who have successfully managed other public companies and established credibility in the financial community may help mitigate underwriter or investor anxiety about an unproven company.

Before undertaking an IPO, you should be confident that your business and your product(s) are sufficiently developed and that your key people are in place. A company that flounders after going public loses credibility in the public markets, and investor confidence is difficult to regain.

Financial considerations

The timing of the offering depends on more than just the underwriter's judgment about the market climate. For example, there must be a number of years of audited financial statements for the company and for significant business acquisitions. Unaudited interim financial statements may also be required, depending on the timing of the anticipated effective date of the registration statement.

There are exceptions to every rule, so it is important that you discuss this with your advisers. If your company does not have a lengthy history, for example, it may be possible to audit prior unaudited years when auditing the current year. It is best to find out before you expend too much effort.

You should review and discuss with your auditor any unusual, complex or significant accounting transactions in the prior three to five years to ensure that the accounting treatment is likely to be accepted by the SEC.

Before going public, you may also have to consider any past aggressive tax positions, with a view to settling likely contingencies to minimize any possible investor concerns.

Legal considerations

After you've made the decision to go public, a substantial amount of preliminary legal "housekeeping" must be performed. All legal agreements, including your articles of incorporation, bylaws, material leases and contracts, should be reviewed and modified if necessary. Any pending litigation should be settled, and any necessary revisions to existing arrangements, such as royalty agreements, should be completed before the IPO.

Some of the basic legal questions involve issues of shareholder approval that may be required for changes in ownership, or the existence of shareholder or control agreements. Your legal counsel is the best source to advise you of the necessary steps.

Other considerations

Legal structure. You should review your company's legal structure with corporate tax and legal counsel to determine whether your current corporate structure is appropriate. Some types of corporate structures may actually hinder or preclude a public offering (e.g., several corporations each owned directly by stockholders).

All public companies must be a regular taxable corporation, or a C corporation. If your company is an S corporation, you must terminate such status and become a C corporation either before the offering or as a result of the IPO transaction.

Capital structure. You may need to simplify a complex capital structure by redeeming any preferred stock or converting those shares into common stock. The number of shares your company has that are currently authorized and outstanding will affect the offering. You may also need to amend your corporate charter to authorize the issuance of more shares to be sold in the IPO.

If you currently have only a small number of shares authorized and outstanding, you may want to split the stock (or, in the case of a very large number of shares outstanding, reverse-split the stock) to bring the number of shares and the price of the stock to an optimal level for the offering.

Restricted stock. Closely held companies generally issue stock referred to as restricted stock, which may have been issued under a private placement exemption contained in the Securities Act of 1933. The stock may be subject to sale restrictions under Rule 144 of the 1933 Act, and therefore, some pre-planning may be needed if you or your current shareholders are contemplating using the offering to make your stock holdings easily saleable. Generally, these shares cannot be resold in the public market unless the stock is either included in a new offering under the 1933 Act or sold pursuant to Rule 144. Your legal counsel can advise you of the requirements with respect to handling restricted stock.

Corporate governance. Both the NYSE and NASDAQ have corporate governance listing standards that must be addressed in connection with the IPO. These listing standards include board and audit committee composition, independence requirements, internal audit function requirements and code of ethics and business conduct requirements for employees and directors. It is important that you discuss your company's corporate governance principles and practices with your attorneys in planning the public offering.

Designating a liaison officer

To facilitate preparations, you should designate a liaison officer to act as a focal point in the process and to ensure that all of the deadlines are met. This should be someone who is familiar with the company, who can work on solutions as soon as problems arise and who has the appropriate authority to drive the process. It is especially important for the liaison officer to provide investment bankers and attorneys with the information they need to move the IPO forward. A delay in gathering the required information can hold up the entire process.

Creating a public image

Long before going public, you should begin to cultivate an image with potential investors and with those who can influence investment decisions. You cannot develop an image and name recognition overnight, and both are very important factors in influencing the initial price of your stock. Consequently, you should begin trying to create favorable impressions of your company with these audiences well before you go public.

Public relations firms, experienced in working with the business press and financial analysts, can be extremely valuable advisers and facilitators in this process. They can help you to:

- Develop lists of analysts and business press editors who follow your industry and regularly provide them with news releases and information about your company.
- Identify the most respected analysts in your industry and target them for either special focus or interviews with you or other members of senior management.
- Obtain invitations to trade association and technical conferences where companies can present themselves to both the press and analysts who frequently attend to keep current in their field. These conferences also offer opportunities for networking with others in your industry.

Public relations firms with investor relations expertise can also help devise other initiatives, which can set up the building blocks for a successful IPO.

Preparing for the transition to public life

You must actively prepare for the transition to public company status. Running a company for outside stockholders to whom you have a fiduciary responsibility is vastly different from running your own company. Furthermore, running a public company introduces another layer of financial reporting and corporate governance compliance over and above existing federal securities laws. You and your key executives must be psychologically ready and appropriately staffed to accept these additional responsibilities.

To prepare properly, many companies begin to operate as if they are public companies well before actually going public. A few key areas are discussed below.

Accounting and finance. The company should begin to generate reliable and meaningful monthly financial statements, so when quarterly reporting is required, the means for producing those reports are already in place. In addition, managers must begin to discipline themselves to analyze operations and results more frequently and must adapt to the pressures of quarterly performance evaluations. Once the company is public, the CEO and CFO need to certify quarterly and annually the financial statements' accuracy, and should be involved in the financial statement closing process.

Management should also begin to design, implement and document the company's internal control processes. In the second annual report the company files with the SEC after completing its IPO and on an annual basis thereafter, management will be required to certify the effectiveness of the company's internal controls over its financial reporting process, and your auditor may be required to attest to the company's effectiveness of internal controls over financial reporting. There are phased-in implementation dates for certain smaller company filers. You should work with your counsel in determining when you must comply with the requirements related to the company's internal controls over financial reporting.

Additionally, the company should build accounting and finance functions to support the accounting and reporting requirements of a public company. The size and composition of these functions will vary, based on the company size and complexity. Frequently, this may mean that certain aspects of the accounting function need to be outsourced to a third-party service provider.

Board composition. Your company's board of directors will be involved throughout the IPO process and will assume greater responsibilities and liabilities after the company becomes public. You therefore want to ensure that the board members have the appropriate credentials, including sufficient depth and experience, and have met the independence requirements. If your existing board consists of friends, relatives or colleagues who do not have the necessary credentials, you should change the board's composition. A strong, qualified board also enhances your company's credibility with potential investors.

The company is also required to have an audit committee, or if no such committee exists, the entire board of directors will be designated as the audit committee. The duties of the audit committee include the following:

- Select, determine the compensation for and monitor the performance of the outside auditor, and resolve any disagreements between management and the independent auditor. The audit committee is required to pre-approve all audit, audit-related and any permissible non-audit services performed by the auditor of record and its affiliated firms.
- Review annual and quarterly financial statements and financial disclosures and discuss them with management and the outside auditor. The audit committee also discusses certain matters, such as the initial selection of accounting principles or changes in accounting methods, with the outside auditor on a quarterly and annual basis.
- Ensure procedures are in place to address complaints regarding accounting, internal controls or auditing matters.

You are required to discuss the operations, historical results and known trends that will, or could, affect operations.

While the rules provide for phase-in periods to comply with certain of the independent director requirements, investors may expect to see IPO companies follow best practices in corporate governance. You should discuss the timing of compliance with these requirements with your attorneys and underwriters in order to understand the potential effects on the offering.

Management's discussion and analysis. The registration statement and all future financial statement filings with the SEC require a quantitative and qualitative discussion of your company's performance and liquidity, known as management's discussion and analysis of financial condition and results of operations (MD&A). You are required to discuss the operations, historical results and known trends that will, or could, affect operations. You will need to disclose the following: significant changes from year to year on the income statement, critical accounting policies, significant estimates, events that may affect working capital and trends that may affect the future. You also need to describe in detail such items as changes in sales volume and cost structure, sources and uses of cash flow, liquidity and capital resources, unusual nonrecurring charges, employee compensation and risks and uncertainties.

As part of your quarterly and annual financial statement closing process, it is a good idea to begin the process of drafting your MD&A. The practice of writing a comprehensive MD&A will assist you during the registration process and will be a major step toward operating like a public company.

Compensation discussion and analysis. The registration statement and all future proxy and information statements, as well as annual periodic report filings with the SEC, require a comprehensive discussion of your company's executive compensation policies and related components, known as Compensation Discussion and Analysis. You need to address such issues as the objectives of the company's executive compensation programs, what performance-based compensation is designed to reward, the elements of compensation, why the company chooses to pay each element and how the company determines the amount for each element.

Selecting professionals to help you

Assembling an experienced team to work with the company through the IPO process is a critical factor in its success. It is imperative that you select advisers who have experience with IPOs, particularly with companies in your industry and of your size. The IPO is a rigorous process and a coordinated effort among the members of your team—company management, board of directors, attorneys, independent auditors, underwriters and their counsel and other advisers as necessary. The primary goal of the team is to complete a successful offering that complies with the applicable laws and regulations.

Attorneys

Since your attorneys are advocates for your position and because an IPO is a highly technical legal process, you will probably be working more closely with them than with any other professional advisers during the offering process.

Attorneys are heavily involved in the disclosure aspects of the IPO and have primary operational responsibility for insuring that your offering complies with federal securities laws. In addition, your attorneys participate in many of the discussions between your company and the investment bank or underwriters.

SEC legal work is complex and highly specialized, so it is extremely important that you have legal counsel with prior SEC experience and who know the intricacies of working with the SEC.

If your general counsel is not experienced in IPOs, ask to be recommended to a firm that is.

Accountants and auditors

The independent accountants also have a key role in the IPO process. In addition to auditing your company's financial statements, they should, with the pre-approval of the audit committee or governing board, be able to, among other things:

- Analyze the tax consequences of the IPO within the limits of the PCAOB independence standards
- Evaluate internal controls over financial reporting as documented by management in order to make recommendations for improvements
- Perform due diligence on potential targeted acquisitions
- Provide benchmarking of comparable public companies' finance and accounting personnel

During the IPO process, the accountants are responsible for auditing the financial statements. They also will read the disclosure documents. The accountants will need to consent to the inclusion of their report in the filing. Generally, your underwriters and their counsel will request that the accountants “provide comfort” on certain financial amounts disclosed in the registration statement. The accountants will issue a “comfort letter” to the underwriters in this regard. Additionally, your

accountants will assist in the resolution of comments raised by the SEC staff in its review of the financial information included in the registration statements, and participate in any discussions with the SEC accounting staff that involves the financial statements or related disclosures.

Your independent accountant should be a firm with a good reputation and extensive experience with the SEC and the IPO process. Audit firms must be registered with the PCAOB in order to prepare or issue audit reports on U.S. public companies. If your current accounting firm is not registered with the PCAOB, it must register or you must find a registered firm. Other accounting firms, including international accounting firms, assisting your independent accountant may also need to be registered with the PCAOB, and any such firm will be required to provide certain consents to your accountant before it does any work related to the audit.

If you engage a new firm, meet with the people who will be working with you and determine the extent to which a partner with SEC and IPO experience will be involved. The earlier and more frequent that involvement, the smoother your IPO process is likely to be.

The accountants remain involved after the IPO process is completed, including reviewing and auditing the company's financial statements for ongoing periodic reporting purposes, as well as assistance with future transactional filings.

Underwriters

Selecting an underwriter is one of the most important decisions in preparing to go public. The underwriter is an investment bank that manages the entire process of analyzing your company and coordinating the sale and distribution of stock at the conclusion of the deal. In selecting an underwriter, consider the following:

Expertise. An experienced investment banker should have a keen sense of what sells in the marketplace and an ability to determine the best timing for a deal.

Reputation. Reputation is critical because investors will associate your stock with the underwriter coordinating the deal. Most underwriters specialize in certain areas and industries. Your underwriter should have a good knowledge of your industry and begin to work immediately to understand your business in particular. Because strength in one area does not necessarily indicate strength in another, look for an investment banker with a track record in offerings for companies in your industry group.

Distribution. The ability to distribute stock to a diverse client base (both individuals and institutions, such as pension or mutual funds) is a key aspect of an investment bank's responsibility.

Research support. After your stock begins to trade on an exchange, it is important that investors know about your company. You should have a respected analyst who covers your industry. Check with institutional investors to see how they rate analysts.

Because of perceived structural problems with the investment banking and research coverage businesses, the SEC and both the NYSE and NASDAQ securities exchanges issued new conflict of interest rules between research analysts and their investment banking firms. The rules essentially limit the interaction between the two and result in less involvement from the research analyst during and shortly after the IPO process. The rules are structured to promote independence and objective research.

The interaction between company executives and research analysts has also changed since the SEC's issuance of Regulation FD (Fair Disclosure), which prohibits selective disclosure of material information. Regulation FD requires that when a public company intends to disclose material information, it must do so through public disclosure. Also, if a company discovers that it mistakenly made a material selective disclosure to stockholders or securities market professionals, Regulation FD requires the company to make prompt public disclosure of the information.

You should consult with legal counsel familiar with these regulations in order to fully understand their implications and your company's resulting obligations.

After-market trading support. The underwriters' trading capabilities and willingness to take positions in your stock are crucial to the success of your IPO. New issues are subject to volatility following the offering. A good investment bank will buy and sell stock in the marketplace to help stabilize the issue. It will also place both its capital and reputation behind your deal.



Letter of intent

After selecting the underwriter, you will be asked to sign a letter of intent.

This preliminary agreement usually details the company's obligations to pay for certain expenses whether or not the offering is completed. The letter of intent also usually includes such terms as the expected number of shares to be sold, the expected offering price, whether the offering will be underwritten on a firm commitment or a best-efforts basis, the underwriter's discount or commissions, responsibility for expenses and preferential rights on future financing.

Underwriters' counsel

Underwriters' counsel is selected by, and works on behalf of, the underwriter. Underwriters' counsel is generally responsible for drafting the underwriting agreement and for discussing the content of the comfort letter issued by the accountant. Counsel is also involved with the review of the registration statement in order to ensure that the document is complete and not misleading. Additionally, underwriters' counsel prepares the "blue sky" filing; blue sky is the general term applied to the states' securities laws. While the company files a registration statement with the SEC, the securities must be qualified under the blue sky laws of the states where the stock will be sold.

Financial printers

The SEC's guidelines regarding format of registration statements and prospectuses are strict and include specific standards as to printing and electronic submission via the SEC's Electronic Data Gathering Analysis and Retrieval (EDGAR) system. There are a limited number of financial printers that specialize in meeting the SEC's requirements. Additionally, these printers are accustomed to the time constraints typical of IPO filings. Your advisers will be able to recommend qualified financial printers.

Other advisers

Transfer agents and registrars specialize in maintaining shareholder records. Transfer agents also assist in stock transactions and coordinate shareholder correspondence and dividend payments. Registrars safeguard against over-issues by keeping track of all issued stock. Registrars are generally part of the same firm as the transfer agent.

Types of underwriting arrangements

Traditional underwritten offerings

There are generally two types of underwriting:

Best-efforts commitment. The underwriters, acting as your agent, agree to use their “best efforts” to sell the securities on your behalf. They have no obligation to purchase any of the securities that do not sell in the open market. There are many variations of the best efforts commitment. In certain situations, the accounting firm may be unwilling to be associated with the financial statements to be included in a best-efforts offering.

Firm commitment. The underwriters are obligated to purchase all of the registered shares at the offering price, less underwriting discounts and commissions. The underwriters then re-sell the shares to the public at the offering price stated on the cover of the prospectus.

Most IPOs are conducted through a firm commitment underwriting.

Dutch auction offerings

Although not common, some underwriters use a method of pricing and distribution called the “Dutch auction,” which differs from the traditional underwritten offering. The public offering price in a Dutch auction is based on bids made by auction participants (including both individuals and institutions), with the price that can sell the total number of shares setting the price for all of the shares in the offering. Since there is no guarantee that all of the shares will sell in a Dutch auction offering and because you have no input into the price of the stock, this form of offering presents a greater risk to the company.

You should discuss the advantages and disadvantages of a Dutch auction offering with your business advisers if you wish to proceed in this type of IPO offering.

Online offerings

A company’s public offering may include an online, or retail, component, and you should decide whether to include an online portion early in the IPO process. Internet-focused underwriters typically play a limited role in the overall deal, with a major portion of the offering still being sold through a lead investment bank.

The IPO process

An IPO requires teamwork among you, your advisers, the board of directors and company personnel on three major tasks:

- Analyzing your company to determine how it should be valued in relation to similar companies in its industry
- Registering the IPO with the SEC
- Marketing the shares to investors

The overall process usually takes about four to five months. The actual length of time to complete the offering process depends on several factors, including market conditions and the availability of information that must be included in the registration statement. A sample timetable showing the steps of the IPO process is provided in Appendix C.

Analyzing the company

Before the IPO, the underwriter analyzes the company to estimate its value and determine the number of shares to offer in the public market. Valuation is more an art than a science, and although the underwriters follow a rigorous procedure in an attempt to factor in all relevant issues, the market sets the actual price. There are three steps in this process.

Performing the valuation. Typically, the underwriter assesses your company's financial strength, including the amount and quality of your earnings, among other factors. Key financial ratios are also evaluated, as are less tangible indicators of strength, such as the quality of your management team, the diversity and depth of your product line, the quality of operations and the nature of your customer base.

The underwriter then compares your company with other similar publicly traded companies (known as "comparables"), which are used as a benchmark to estimate the value (or capitalization) of the company in the marketplace. Almost all IPOs are priced at a discount to their comparables (called a "haircut"), because the shares do not have an established track record as a public security.

Determining the percentage of the company to offer

Once you have an idea of your company's estimated market capitalization, you must decide how much of the company you wish to offer to the public. You must balance your need for capital with the amount of control you want to maintain. The larger the percentage of the company that is sold, the greater the amount of cash that can be raised, but also the greater the degree of control that must be relinquished. The decision is not an easy one because you must sell a sufficient amount to provide investors with trading liquidity.

Determining the number of shares to sell.

Generally, the greater the number of shares offered, the lower the price per share. Smaller, individual investors prefer a low price per share because it makes it possible to buy and sell small dollar values of stock and takes fewer dollars to trade a “round lot,” which equals 100 shares. However, institutional investors tend to favor a larger per-share price. Therefore, the decision about the number of shares to offer is usually based on the type of investor most likely to buy the issue.

Due diligence

While the investment bankers are valuing your company, they also are performing a due diligence examination — an exhaustive process of insuring the accuracy and completeness of all information about the company.

The due diligence examination involves sessions in which key management personnel are questioned about company activities that may or may not be disclosed in the prospectus. Your attorneys and the underwriters’ counsel review all significant corporate documents (articles of incorporation, by-laws, minutes of board meetings, major contracts, employment agreements, stock option plans, etc.) to verify that the prospectus disclosures are accurate. Your attorneys also extensively examine your business and the activities of your company during this time.

Although the due diligence examination is most intensive during the first several weeks, activity continues throughout the registration statement process. For example, during this time your attorneys and the underwriters’ attorneys may distribute questionnaires to the company’s directors and officers requesting them to review, verify and comment on the information contained in the draft registration statement. The attorneys may also interview directors and officers.

As part of their due diligence procedures, the underwriters will request comfort letters from your independent accountants with respect to information that appears in the registration statement but not in the financial statements, and on events that occur after the accountants’ report date. It is common for underwriters to request comfort on as much information as possible. Because there are limitations on the information on which your accountants will provide comfort, it is important that you, your accountants and your underwriters meet in the early stages of the registration process and discuss this information. Generally, the more information for which the underwriters seek comfort and which the accountants are able to provide, the more expensive the process becomes.

Ordinarily, comfort letters are issued to the underwriters on the effective date of the registration statement, followed by an updated letter at the closing date. In some instances, they may also be issued at the initial registration statement filing date.

Generally after the registration statement is filed but before it becomes effective, the principal underwriter usually conducts a due diligence meeting of the principal members of the underwriting group, the independent accountants, attorneys, counsel for the underwriter, the company’s senior officers and you.

At this meeting, the members of the underwriting group have the opportunity to exercise additional due diligence by asking further questions concerning the company and its business, products, competitive position, recent financial developments, marketing, operations and other areas and future prospects.

SEC registration

Drafting the registration statement. The SEC created the registration process to ensure that any company making a public offering fully discloses all important financial information to investors. To register, a company submits its financial biography to the SEC on a specified form (Form S-1), which comprises the registration statement, a portion of which becomes the prospectus. In addition to the required financial statements, the registration statement contains a great deal of information about the company. It includes, among other things, the following:

- A description of the business
- Management’s discussion and analysis of the company’s operations, liquidity and capital resources
- Use of proceeds from the offering
- A section on the risks associated with the business and with the offering
- A description of key members of the management team and major shareholders and their financial relationships with the company

Preparing and filing the registration statement requires substantial planning and coordination due to its complicated and highly technical aspects. Drafting and reviewing the registration statement requires a significant amount of time and effort from the management team and your advisers, although the ultimate drafting responsibility typically falls on the management team and company counsel.

In addition to federal securities laws, companies must adhere to state securities laws or blue sky laws. While the federal rules focus on the disclosure of information, some states add fairness or merit requirements and may consider such factors as the offering’s fee structure or the possibility for undue benefits to company insiders.

Review by SEC staff. The SEC Division of Corporation Finance staff reviews the registration statement to ensure that all required information is properly disclosed and that the presentation (including the financial statements) is satisfactory. *The staff does not evaluate the investment merits of the IPO or the risks associated with the proposed new issue.*

After reviewing the initial registration statement filed with the SEC, which usually takes approximately 30 to 45 days, the SEC staff in most cases issues a letter that calls attention to specific items in the registration statement that it believes must be clarified or revised before the registration can become effective. This letter is commonly referred to as a “comment letter,” and is typically faxed to the company’s attorney. There are usually a series of comment letters issued to the company.

Management and the company’s legal counsel usually draft the company’s response to each of the comment letters. Every comment within each letter must be addressed and resolved in writing before the registration statement can become effective. It is also important to involve your independent accountants in the review of your responses, particularly for matters related to accounting and reporting. In some cases, a meeting with the SEC staff may be necessary to clarify certain comments or issues. The company then files a “pre-effective amendment” that addresses any required issues raised in the comment letter.

Every comment within each letter must be addressed and resolved in writing before the registration statement can become effective.

Exchange listing

Early in the offering process, you should decide where to list your company's stock. Listing on an exchange is the primary method for achieving stockholder liquidity and is generally required by underwriters. The company's counsel assists in preparing the exchange listing application and reserving the company's proposed trading symbol. Each exchange requires that companies meet certain quantitative and corporate governance standards, although the specific requirements vary among the exchanges. You should review the requirements of the desired exchange with your counsel and determine the likelihood that your application will be approved.

All the exchanges have different standards for initial listings and for continued listings. Listing standards are frequently updated; you can obtain the current listing requirements at the following Web sites: www.nyse.com, www.nasdaq.com and www.amex.com.

Communications during the offering

The SEC restricts the information your company can release to the public during the IPO process. In 2005, the SEC adopted modifications to the offering processes. Among its many provisions, the rules liberalize permitted offering activities and communications to allow more information to reach investors. You should work with your attorneys in understanding what you can communicate to the public during your IPO.

The red herring

To distribute information to prospective investors, your company is permitted to use a draft copy of the registration statement, or preliminary prospectus, which has been submitted to the SEC. This draft copy is called a "red herring" because the cover of the document contains a red-lettered statement emphasizing the document is only a draft. The red herring does not contain the date of the offering or its price.

Marketing and selling the deal

The road show. While your company awaits final approval from the SEC, your investment bankers organize the "road show," an informational tour designed to publicize the upcoming offering to professional money managers. The road show is important for both buyers and sellers because it provides a venue for them to gather information. Buyers want to know more about your company, and sellers want to gauge the level of interest among prospective buyers.

Syndication. After the registration statement is filed with the SEC, your underwriter organizes a group of other investment banks to coordinate the distribution of stock to the investment community. This group is called the "syndicate," and each member is responsible for selling a certain amount of stock.

During the waiting period, the lead manager is in contact with the other syndicate members to determine how much interest exists in the marketplace for your offering. If market sentiment changes during this period, the offering price is adjusted accordingly.

All the exchanges have different standards for initial listings and for continued listings.

Pricing the stock. While the analysis that forms the basis for a stock's preliminary valuation is performed at the beginning of the IPO process, the actual pricing of the stock is established immediately after the SEC approves the registration statement. The stock price is based on the marketplace's initial valuation and the degree of interest in your offering. During the road show, your underwriter has a good opportunity to gauge this interest.

The underwriting agreement. The underwriting agreement is drawn up between your company and your investment banker the day before the stock is sold to the public. Both parties agree on the offering price of the stock and the commissions, discounts and other expenses incurred during the underwriting process. The underwriting agreement also specifies the terms of any underwriters' over-allotment option, or "green shoe," as it is commonly known. In a green shoe, the company grants the underwriters the option to purchase up to 15 percent of additional company shares over the original offering size at the offering price. This provides the underwriters the right to sell additional shares if demand for the securities is in excess of the original amount offered.

In addition, the underwriting agreement carefully lays out each party's responsibilities during the offering process, as well as after the underwriting agreement is signed. The underwriting agreement is signed on the day the registration statement is declared effective by the SEC. Once the underwriting agreement is signed, the SEC is notified of the offering price, the registration statement is declared effective and the offering begins.

Aftermarket trading. Trading begins when the deal is priced on the day after the registration statement becomes effective. The lead manager of the underwriting syndicate allocates the stock among the members who, in turn, sell the stock to their clients. The allocation and initial stock sales are based on interest expressed by members' clients after reading the red herring or attending the road show.

The closing

Three to five business days after the stock is priced, the underwriter and the company exchange cash for stock. An updated comfort letter prepared by the independent accountant is also delivered.

As part of the closing process, underwriters want to ensure that the officers, directors and large shareholders of the company do not sell their shares shortly after completion of the IPO. The underwriters will request that these parties enter into what is known as "lock-up agreements," which prohibit the sale of shares for a period following the offering. Lock-up agreements typically span 180 days.

Once you receive the proceeds of the offering, you are required to report to the SEC, among other things, how the proceeds are used. The company must justify any differences between the "Use of Proceeds" section in the prospectus and the intended use of the funds. The company is required to report the use of proceeds in either its first quarterly report or annual report, whichever is filed first, after the effective date of the registration statement, and thereafter in each of its quarterly reports and annual reports until all the proceeds are used.

Costs of going public

The costs associated with going public are significant. The majority of the costs incurred during the IPO process are reflected as a reduction in the amount of additional paid-in capital generated by the offering. If the IPO is not completed or is postponed for a period of more than 90 days, all these costs are charged to expense.

The major expenses associated with an IPO are summarized in the remainder of this section.

Underwriters' compensation

The underwriters' discount, or commission, can range from 6 to 9 percent of the public offering price of a new common stock issue, with 7 percent of the offering price being the most common. In smaller offerings, some underwriters may request other compensation, such as warrants, the issuance of stock to them at a price below the public offering price, a right of first refusal on future offerings or reimbursement for their counsel's fees or other expenses.

The SEC will not declare a registration statement effective until the National Association of Securities Dealers (NASD) has approved the underwriting arrangements. Part of NASD's review is to consider whether the fees charged by the underwriter are reasonable.

Out-of-pocket expenses

In addition to the underwriters' commission, an IPO involves out-of-pocket expenses that are incurred regardless of whether the offering is successful.

Because each offering's facts and circumstances vary, the resulting out-of-pocket costs vary. If problems or unexpected circumstances arise, the costs can increase substantially. Out-of-pocket expenses cover a range of activities, including those discussed below.

Legal fees. Legal fees vary considerably with the circumstances and generally include the following:

- Corporate "housekeeping" work related to the offering
- Preparation of the registration statement
- Negotiation of the underwriting agreement
- Closing of the sale of securities to the underwriters

Charges allocated to "housekeeping" are usually treated as current business expenses for accounting purposes.

The legal fees are usually higher if there is a large number of selling shareholders because of the legal and administrative work required for each seller. Legal fees are also usually higher for offerings that present complex legal issues. Your company may also agree to pay part of the fee for the underwriters' counsel.

Accounting and audit fees. Accounting and audit fees depend on your company's size and the complexity of your operations. Fees may be lower if your accountants have conducted regular audits for the past few years and have completed the audit of the current year.

Fees may be somewhat higher if your company is required to include interim audited or unaudited financial statements in the registration statement, and significantly higher if there are no prior audits. Accounting fees may also be higher for offerings that present complex accounting, auditing or tax issues. Additionally, if separate financial statement audits of businesses acquired or to be acquired are required, the accounting fees will be higher. The accountants' fees include the following:

- Audit of the financial statements
- Review of the registration statement
- Assistance in responding to SEC staff accounting comments
- Preparation and delivery of the comfort letter to the underwriters

These fees are treated as a period expense and cannot be deducted from the proceeds generated by the offering.

Printing costs. These costs cover printing of the registration statement, the prospectus, the stock certificates and the underwriting documents. The registration statement and prospectus account for the largest portion of the printing expenses, which are governed by the length of the prospectus, the number of prospectuses and the number of corrections.

Infrastructure and other costs. Many growing companies require additional competencies in order to staff an accounting and finance function for a public company. The costs for building the required staff, including the corporate governance and internal control infrastructures, depend on the size and complexity of your company.

Other miscellaneous costs are associated with the process of going public. These include SEC and NASD filing fees, which are based on the size of the offering, blue sky filing fees and registrar and transfer agent fees. There are also fees for listing with any of the national securities exchanges.

Accounting and audit fees depend on your company's size and the complexity of your operations.

A whole different ballgame

A successful IPO is only the beginning. Life in a public company is significantly different from life in a private one. Going forward, your company will be subject to new schedules, new deadlines and a host of new regulations and procedures.

In particular, your relationship with a wide range of constituents will differ significantly now that you are public.

Key audiences include the following:

Investors/shareholders

Investors are now the owners of your company. You need to provide regular reports to shareholders and involve them in key votes based on the number of shares they hold. Activist shareholders with substantial investment in your company may pressure you to make certain decisions. Shareholder communication is now a critical component of your business operations.

Financial analysts

In order to ensure that investors have information about your company and that interest in your activities remains high, it is important to have a respected analyst covering your company. The analyst should be an expert with a track record of covering other companies in your industry.

Regulators

As a public company, you are required to file quarterly and annual reports with the SEC. In addition, you are required to file current reports between the due dates of the quarterly and annual reports if certain significant events occur that are subject to the SEC's reporting requirements. You may also be required to file information or proxy statements. If your company's shares trade on an exchange, you must comply with the ongoing listing requirements of that exchange.

Media

Chances are you had relationships with members of the press while you were a private company, but they will be more critical after you go public. You must cultivate members of the press, either directly or through a public relations agency, in order to help shape the image they convey to investors and members of the general public.

How you work with the following service providers will change as well:

Independent auditor

As a public company, your outside auditor and its affiliated firms may not provide certain non-audit services, including financial information systems implementation, bookkeeping, loan staff, appraisal and valuation services and internal audit services. All audit, audit-related and permitted non-audit services must be pre-approved by the audit committee.

Legal counsel

Management and the board of directors should meet with company counsel to discuss your obligations and responsibilities with respect to numerous public company rules and regulations. You may need legal counsel that specializes in SEC matters in addition to your corporate counsel. The federal securities laws are extremely complex, so it is important that your legal counsel is experienced, to ensure the company's compliance.

Investor relations

A public company needs professionals to handle communications with investors. This includes managing the investor relations portion of your Web site, developing your investment profile, writing and disseminating press releases and media alerts and handling investor and media inquiries.

Managing these relationships and adhering to the regulations governing public companies command a significant amount of your time. Nevertheless, access to the public markets will open opportunities for growth and development that are probably unavailable to a private entity. How you take advantage of them is up to you!

The federal securities laws are extremely complex, so it is important that your legal counsel is experienced, to ensure the company's compliance.

Appendix A

The U.S. Securities and Exchange Commission

In response to the stock market crash of 1929, Congress enacted the federal securities laws, the Securities Act of 1933 and the Securities Exchange Act of 1934, and established the Securities and Exchange Commission (SEC) to enforce these laws and protect investors. The purpose of these laws is to ensure that investors have access to material information about publicly traded securities and to protect investors in fairly operated securities markets.

On July 30, 2002, President George W. Bush signed into law the Sarbanes-Oxley Act of 2002 (Sarbanes), which focuses primarily on five principal areas of securities reform:

- Expanded responsibilities for management, its board of directors and the audit committee
- Creation of the independent Public Company Accounting Oversight Board (PCAOB, discussed below)
- Enhanced financial disclosures
- Reduction in analyst conflicts of interest
- Expanded penalties for securities fraud

Certain provisions were effective immediately. Others were delegated to the SEC to adopt final implementation rules or potentially expand on the new requirements.

The PCAOB is an independent, non-governmental, non-profit corporation created by Sarbanes to protect the interests of investors and to help restore public confidence in independent auditors' reports. The PCAOB is charged with the registration and oversight of public company auditors. It also establishes auditing standards and related attestation standards used by registered public accounting firms in the preparation and issuance of auditors' reports. The PCAOB utilizes four primary tools to fulfill its mission: registration, standards, inspections and enforcement. The SEC oversees the PCAOB and coordinates its investigations.

There are five commissioners at the SEC, all appointed by the president of the United States with the advice and consent of the Senate. The president also designates one of the commissioners as chairman, the SEC's top executive. The commissioners all have five-year terms, staggered to end June 5 of each year. The SEC is headquartered in Washington, D.C., consists of 4 divisions and 18 offices and has 11 regional offices throughout the United States. A summary of the divisions and the principal offices of the SEC follows.

Division of Corporation Finance

The Division of Corporation Finance oversees public companies' compliance with disclosure requirements when stock is initially sold and then on a continuing and periodic basis. The division performs this function through routine reviews of documents filed with the Commission, including registration statements for newly offered securities, 10-Ks, 10-Qs, 8-Ks, proxy materials, documents concerning tender offers and filings related to mergers and acquisitions. The division also issues interpretations of the Commission's rules and recommends new rules for adoption. It also works closely with the Office of the Chief Accountant (see below) to monitor the activities of the Financial Accounting Standards Board (FASB) that are related to the formulation of generally accepted accounting principles (GAAP).

Division of Trading and Markets

The Division of Trading and Markets oversees the registration and regulation of the major securities market participants: broker-dealers, self-regulatory organizations (which include the stock exchanges) and others (such as transfer agents). The division also oversees the Securities Investor Protection Corporation, which is a private, non-profit corporation that insures the securities and cash in customer accounts of member brokerage firms against the failure of those firms.

Division of Investment Management

The Division of Investment Management oversees and regulates the investment management industry and administers the securities laws affecting investment companies (including mutual funds) and investment advisers. The division ensures compliance with regulations regarding the registration, financial responsibility, sales practices and advertising of investment companies and investment advisers. The division also reviews investment company registration statements, proxy statements and periodic reports filed with the Commission.

Division of Enforcement

The Division of Enforcement enforces the federal securities laws by investigating possible violations of these laws, recommending Commission action if appropriate and negotiating settlements on behalf of the Commission. The division obtains evidence of possible violations of the securities laws from many sources, including its own surveillance activities, other SEC divisions, self-regulatory organizations and other securities industry sources, press reports and investor complaints.

Office of Compliance Inspections and Examinations

The Office of Compliance Inspections and Examinations is responsible for administering the examination and inspection program for registered self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies and advisers. The office conducts inspections to foster compliance with the securities laws, to detect violations of the law and to keep the Commission informed of developments in the regulated community.

Office of the Chief Accountant

The Office of the Chief Accountant is the principal adviser to the Commission on accounting and auditing matters. The Office of the Chief Accountant also works closely with domestic and international private-sector accounting and auditing standards-setting bodies (e.g., the FASB, the International Accounting Standards Board, the American Institute of Certified Public Accountants and the PCAOB); consults with registrants, auditors and other Commission staff regarding the application of accounting standards and financial disclosure requirements; and assists in addressing problems that may warrant enforcement actions.

For more information on the SEC, visit its Web site at www.sec.gov.

Appendix B

Comparison of certain disclosure requirements

Form S-1, Regulation A and Smaller Reporting Company scaled disclosure alternatives

In an attempt to streamline and simplify regulation, on November 15, 2007, the SEC adopted rules that establish “smaller reporting companies,” defined as those registrants with less than \$75 million in public float (or less than \$50 million in revenues for those registrants whose public float is in calculable). These amendments to the disclosure regime for smaller reporting companies integrated a scaled set of disclosure requirements (formally, Regulation S-B) into Regulation S-K for non-financial disclosures and Regulation S-X for financial disclosures. Smaller reporting companies may elect full or partial compliance with the scaled disclosure requirements.

	Registration statement on Form S-1	Registration statement on Form S-1 for Smaller Reporting Company	Offering statement under Regulation A exemption (1)
Issuer Qualifications	None – can be used by any issuer	(2)	(3)
Size of Offering	No limit	(4)	\$5 million in any 12-month period (including no more than \$1.5 million by selling shareholders)
Audited Financial Statements (5)	Two years of balance sheets; three years of income, cash flow, comprehensive income and equity statements	Two years of balance sheets, statements of income, cash flows, comprehensive income and equity	Balance sheet for one year; two years of income, cash flow and equity statements (statements may be unaudited unless audited statements are available)
SEC Technical Requirements	Regulation S-X and Regulation S-K (6)	Article 8 of Regulation S-X and scaled disclosure alternatives contained in Regulation S-K	Form 1-A (question and answer format available as alternative)
Selected Financial Data	Five years	Not required	Not required
Management's Discussion and Analysis	Three years	Two years (in less detail than S-1)	Certain relevant factors up to two years
Executive Compensation	Disclosure for five named executives, Summary Compensation Table for three years, Compensation Discussion and Analysis, seven summary tables	Disclosure for three named executives, Summary Compensation Table for two years, Compensation Discussion and Analysis not required, three summary tables	Not required
Description of Business	Developments during last five years	Developments during last three years	Developments during last five years
Supplemental Schedules	Certain specified schedules are required	Not required	Not required
Quarterly Data	Required for certain companies, but not required in an IPO for any company	Not required	Not required
Other			"Test the waters" provisions (7)

Notes:

(1) Although Regulation A is referred to as an exemption, Regulation A merely provides less stringent requirements for certain small offerings.

(2) "Smaller reporting company" is defined as those registrants with less than \$75 million in public float (or less than \$50 million in revenues for those registrants whose public float is incalculable). In filing an initial registration statement, companies must determine whether they are eligible for smaller reporting company status by computing public float on a date within 30 days of the filing. Public float is based on three components: (i) estimated offering price per share at the time of filing the registration statement, (ii) number of shares of common stock outstanding that are held by non-affiliates before the offering, and (iii) number of shares of common stock to be sold at the estimated offering price. Smaller reporting companies are not investment companies or asset-backed issuers. Smaller reporting company status permits the company to elect scaled disclosure requirements, as compared with the more robust disclosure requirements for companies that do not qualify as smaller reporting companies.

(3) A U.S. or Canadian company that does not report under the Securities Exchange Act of 1934 may use Regulation A. The Regulation A exemption is not available to a development-stage company with no specific business plan or to an investment company either registered or required to be registered under the Investment Company Act of 1940.

(4) There is no limitation on the size of the offering. However, to qualify as a smaller reporting company eligible for scaled disclosures, public float must be less than \$75 million.

(5) If financial statements are as of a date 135 days or more before the effective date, unaudited interim financial statements are required. If the effective date takes place 45 days after year-end, the most recent fiscal year's audited financial statements are required. Regulation A filings require interim financials if filing takes place more than 90 days (six months with SEC permission) after year-end.

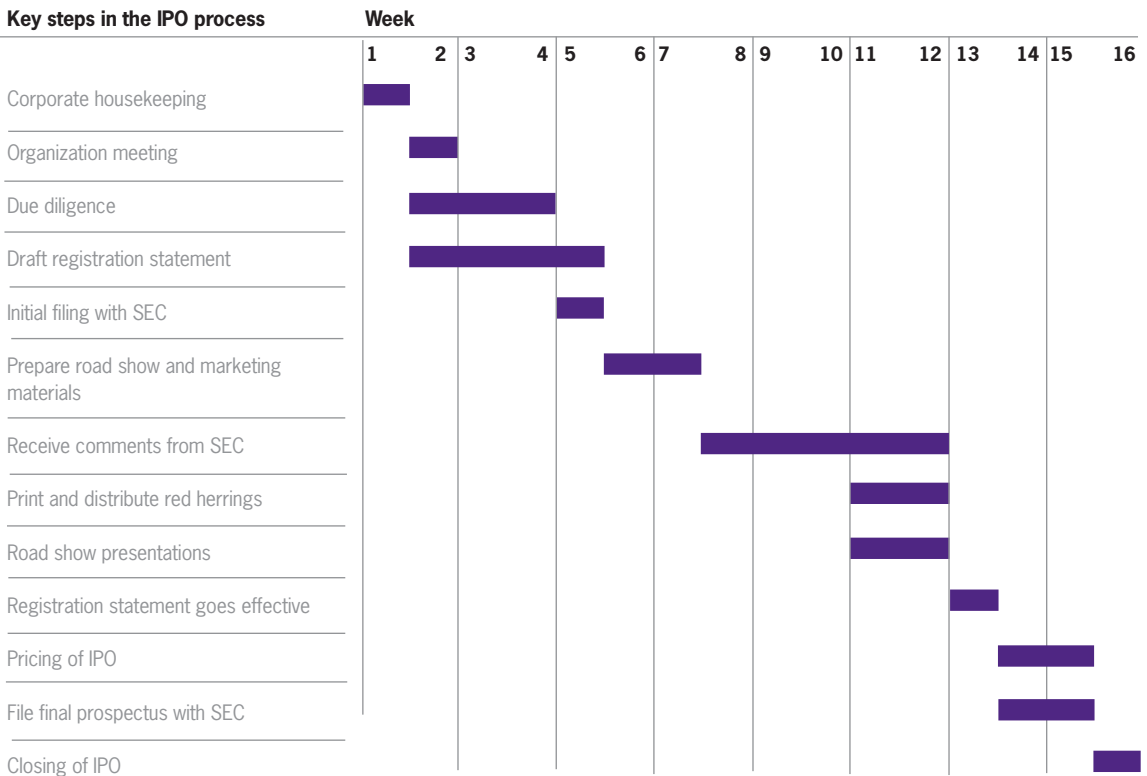
(6) Regulation S-X specifies the financial statements required and provides guidance on their form and content. Regulation S-K contains the disclosure requirements for the non-financial portions of forms.

(7) May solicit, under prescribed conditions, indications of interest in a contemplated Regulation A offering before filing offering circular with the SEC.

Appendix C

Sample IPO timeline

The following provides an example of an IPO timeline. It should be noted that this is only an example; there are many variables that may cause the timing to be accelerated or delayed. You should work with your advisers to develop a working timeline as you begin the IPO process.



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