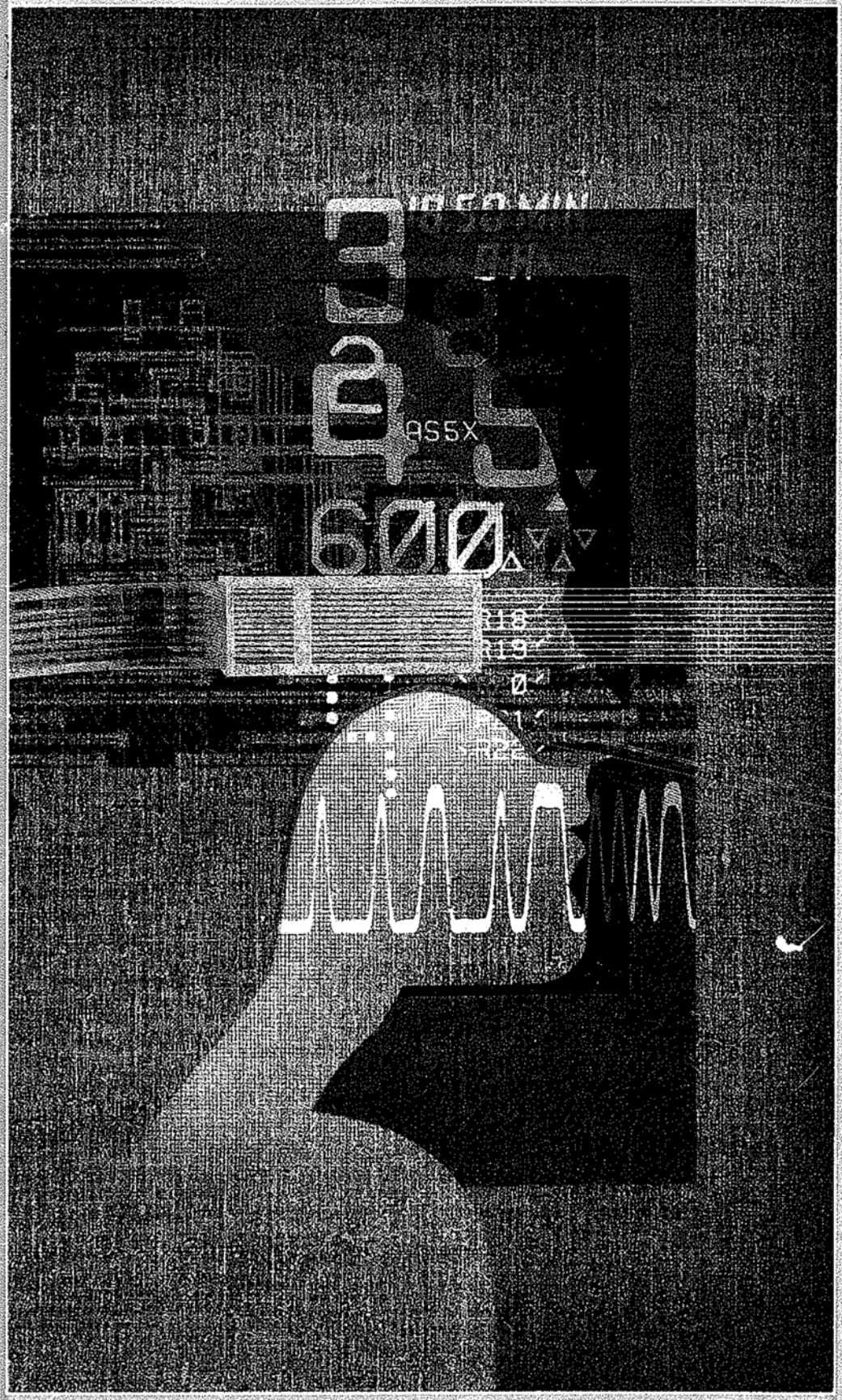
KPMG Peat Marwick

high technology practice



guidebook

What the High Technology CEO Needs to Know

going public guidebook

Prepared by the High Technology Practice
Peat Marwick

Why This Guidebook on Going Public?

At Peat Marwick, we have great enthusiasm for the future of technology . . . for the entrepreneur who has an idea . . . for the emerging company with an innovative new product . . . for the growing company seeking capital to expand its business.

To assist technology-based companies in gaining their opportunities and meeting their challenges, we have developed resources that can truly benefit them at every stage of their development. One of these resources is a series of guidebooks on subjects important to technology-based businesses.

This guidebook, *Going Public: What the High Technology CEO Needs to Know,* is the second in a series. It reflects the experience that we have gained in assisting many technology-based businesses with the going public process. It describes the path to the public market . . . including the events in the life of the high technology company that tell the CEO that the company is ready to go public . . . the advantages and disadvantages of being a public company . . . the sequence of events in the registration process . . . the key players and their respective roles . . . and the commitment required to go forward as a public company.

There is a special section in this guidebook, describing an area of opportunity often overlooked . . . "The Foreign Exchanges." Investor interest is strong in other countries for young and emerging, as well as more established, U.S. high technology companies. The special section will describe some of the important things a U.S. high technology company needs to know about the opportunities to go public on the London, Vancouver, Toronto, Paris, Frankfurt, Amsterdam, Hong Kong, and Singapore securities exchanges.

Going public is a very significant event in the life of a high technology company. Often it serves as a springboard to accelerated growth and success. Because of the importance of this decision and this event, we have developed *Going Public: What the High Technology CEO Needs to Know* to help you, the CEO, analyze the major practical business, legal, and economic considerations of going public. We hope you will find it helpful. We have also included a detailed glossary of terms to help you sort through some of the unfamiliar technical jargon used in the going public process.

A word of caution—there are pros and cons of going public and it is a complex process. Also, the public equity markets, in the United States and abroad, are very dynamic and are governed by specific regulations. The information in this guidebook is subject to changes in these regulations. As you analyze the decision to go public, contact your professional advisers to be sure that you are using the most current information.

If you would like, in addition, to receive our earlier guidebook, *Small Business Innovation Research Grants: How to Obtain Them to Finance Your Ideas* (or wish to be added to our mailing list for announcements of future seminars and guidebooks), just fill in and mail the card in the back pocket of this guidebook.

Tom Moser

S. Thomas Moser
National Director
High Technology Practice

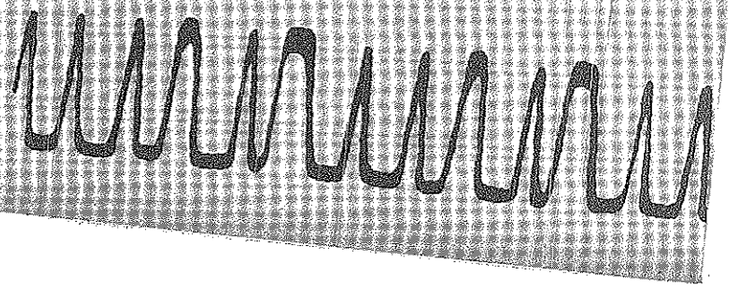
contents

Going Public: What the High Technology CEO Needs to Know

chapter one	**Is My Company Ready to Go Public?**	1
	The Path to the Public Market	2
	A Bypass to the Exchanges	3
	The Challenge	3
	Characteristics That Typify a Successful Public Company	4
chapter two	**What Is My Strategy Before I Begin?**	5
	The Opportunities	6
	The Strategy	6
	The Role of the CEO	6
	Weighing the Advantages and Disadvantages	7
chapter three	**If I Go Public—What Is the Process? Who Can Help Me? What Does It Cost?**	11
	The Sequence of Events	12
	The Underwriters	13
	The Accountants	18
	The Attorneys	20
	Underwriter's Counsel	21
	The Printer	21
	Communications Strategy	21
	The Cost of Going Public	22
chapter four	**If I Go Public—How Do I Assess My Management Team and My Board of Directors?**	25
	The Assessment of the Management Team and the Board of Directors	26
	The Business Plan	27
	The Compensation Strategy	27
	Comprehensive Personal Tax Strategy	27
	Directors' Insurance	28

Is My Company Ready to Go Public?

chapter one

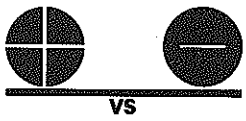


What Is My Strategy Before I Begin?

chapter two

While the CEO may delegate many of the tasks associated with drafting the registration statement to the chief financial officer, the CEO must be actively involved. Furthermore, under the '33 Act, each member of the company's board of directors and certain members of its management team are subject to civil and criminal liabilities for misstatements or omissions in the registration statement and/or prospectus. *Each member of the management team must read the entire registration statement and consider the implications of all revisions.* CEOs who have been through this process consistently say, *"I underestimated the time required to prepare the registration statement."*

Weighing the Advantages and Disadvantages



If the CEO decides to take the high technology company public, the initial public offering may open up many opportunities for the company's growth. Because the decision to go public is an important one, the CEO must weigh carefully each advantage and each disadvantage.

Additionally, while weighing the advantages and disadvantages, the CEO and major shareholders should consider compensation and personal tax strategies. Items to be addressed by the strategies are described in Chapter Four.

The Advantages

- *New capital for the company.* New capital may be generated for research and development, acquisition of property, reduction of existing debt, working capital, plant and equipment, or other important uses to contribute to the company's development and growth.



- *Personal wealth.* Initial public offerings have the potential for raising millions of dollars for the company and for its founders and early-stage financial backers. Whether the CEO sells a portion of stock during the initial public offering or seeks to use publicly traded stock as loan collateral for other investments, going public presents the opportunity for dramatically increased personal wealth.

- *Compensation vehicle.* Stock-based compensation plans for a publicly traded company provide excellent opportunities for attracting and retaining managers and key employees.

- *Improved financial condition.* The sale of equity securities will increase the company's net worth and generally improve its borrowing capability. If the company's stock does well in the public market, additional equity can be raised on favorable terms. Management thus increases its financing alternatives.

- *Acquisitions.* A company with publicly traded stock is in a position to make acquisitions by offering its own stock, thereby not incurring additional debt or decreasing working capital.

- *Prestige.* By becoming a public company, management is undertaking a long-term commitment. Some suppliers and customers prefer to do business with companies in which financial statements are publicly available.

- *Marketable holdings.* Once a company goes public and a market is established for its shares, the shareholders can readily determine the market value of their holdings. The market for the shares establishes a high level of liquidity for the shareholders' investments. (Chapter Six contains information about the timing limitations on disposition of shares for major shareholders.)

In Summary . . .

Perspective: The CEO

The Opportunities:

- Intrigue
- Achievement
- Financial success
- Public stature

The Strategy

The Role of the CEO:

- Planning, strategizing, and decision making
- Selecting the underwriter and professional advisers
- Delegating to management
- Committing time

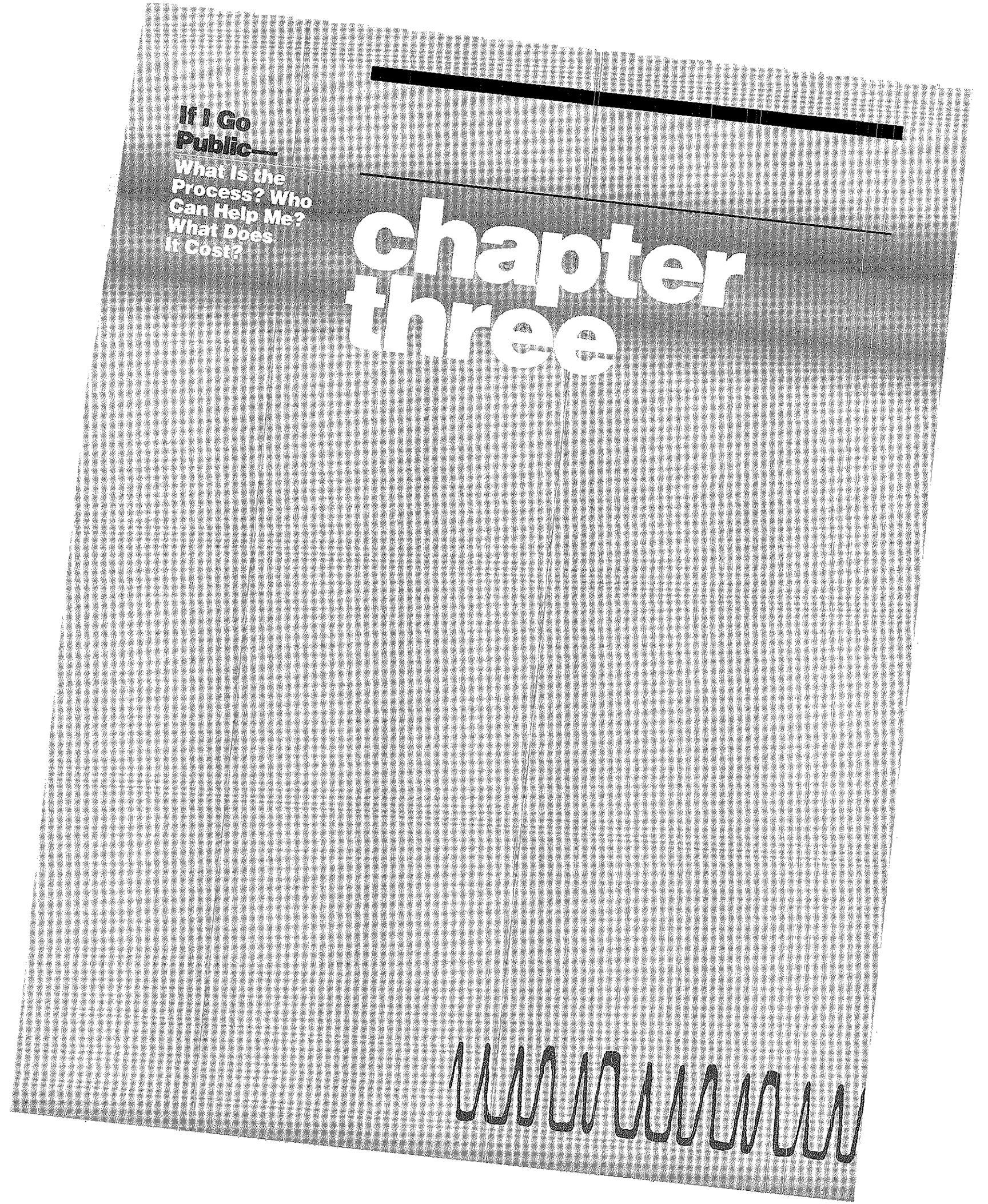
Weighing the Advantages and Disadvantages:

- The advantages
  - — New capital for the company
  - — Personal wealth
  - — Compensation vehicle
  - — Improved financial condition
  - — Acquisitions
  - — Prestige
  - — Marketable holdings
- The disadvantages
  - — Stock price emphasis
  - — Life in a fishbowl
  - — Expenses
  - — Loss of voting control

chapter three

If I Go Public—

What Is the Process? Who Can Help Me? What Does It Cost?



The Underwriters

The underwriter is the conduit through which securities are sold publicly

The underwriter, or investment banker, is the conduit through which the securities of the company will be sold to the public. An underwriting generally consists of an investment banker purchasing securities from the company or the company's major shareholders and selling those securities to the public.

The investment banker who takes the lead in purchasing the securities is called the managing underwriter. The managing underwriter forms a syndicate of other investment banking firms that participate in the purchase of securities from the company and any of its major shareholders and then participate in the sale and distribution of these securities to individual and institutional investors.

While a company can sell securities without an underwriter, the chances of a successful initial public offering are significantly increased when the services of an underwriter are used. *Because of the investment bankers' knowledge of market conditions, their experience in pricing securities, and their ability to arrange the securities' sale and distribution, they are considered to be an invaluable resource in taking the securities to the public market.*

Selecting the Underwriter

Not every large investment banking firm specializes in initial public offerings for high technology companies. However, during the past two years, more than 30 investment banking firms have underwritten initial public offerings for high technology companies priced at more than $5 million. These firms vary broadly in reputation, experience, and ability. Therefore, the CEO should consider the following criteria in selecting the managing underwriter:

- *Reputation and distribution capability.* Individual and institutional investors consider the association of the managing underwriter with the high technology company's offering to be one of the most important factors in deciding to purchase shares. Therefore, the better the managing underwriter's reputation, the easier it will be to sell the shares. The managing underwriter's name should be well known and respected in the financial marketplace. The managing underwriter advising the company should also have a reputation for successful initial public offerings in the high technology industry.

The underwriter's reputation is crucial in forming a strong syndicate

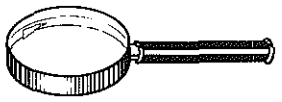
A managing underwriter with a good reputation can assemble a strong underwriting syndicate. Depending upon the size of the offering, the underwriting syndicate may be made up of 10 to 120 investment banking firms.



The strength of the syndicate becomes an important factor in the sale and distribution of the securities. Important criteria for a strong syndicate are a security-holder base made up of a large number of investors holding relatively small quantities of stock, a broad distribution of securities resulting in a large trading market, and high-quality institutional investors. Conversely, a syndicate whose distribution is limited to a few investors could strangle the market for those securities, could depress the value of the securities through selling in large quantities, and could position itself to take control of the company.

- *Experience.* The managing underwriter should have experience in initial public offerings and expertise in the high technology industry. Since most investment banking firms specialize in particular industries and technologies, the CEO should select an underwriter who is conversant with the high technology industry and understands the nature of the high technology company's products and position within the industry. The high technology company employing this degree of selectivity increases its chances for a strong syndicate, a successful initial public offering, better-priced securities, and a favorable reception from the analysts and institutional investors.

The investment banker invests a significant amount of time and expense in the preliminary discussions and investigation before determining whether an emerging high technology company is ready to go public, and at what price the securities should be offered to the public.



► *The investigations.* The investment banking firms that are interested in the growing high technology company and its prospects for going public will perform preliminary investigations. At this stage, the investment banking firms determine whether they want to be involved in the going public process.

Investment banking firms research the company's potential—this may take several weeks

Because the investment banking firms want to make reasonable and responsible investigations, the preliminary investigation can take several weeks. It will include discussions with management, suppliers, customers, legal counsel, and the accountants. Management should be prepared to present the merits of the growing high technology company to the investment bankers. The investment bankers, looking for typical characteristics of high technology companies that go public, will investigate the following matters:

—The quality, integrity, and experience of management
—The financial position and results of operations for the past five years, or since inception
—The company's position within the high technology industry, the quality of its products, and its potential for growth
—Sources of supply, and the nature of customers
—The intended use of proceeds from the initial public offering

Major shareholders are expected to share financial risk

Because the integrity and experience of management are such critical factors in the investigations, the investment bankers will focus on reaching an agreement about the number of shares, if any, that the major shareholders will offer for sale. Offerings by shareholders, referred to as secondary offerings, can have an adverse effect on the underwriter's ability to sell stock to investors. Because the major shareholders in a high technology company are often the same people as those on the management team, they are expected to share with the investors in the financial risk. If the major shareholders are unwilling to share in the risk and choose instead to dispose of their financial interest in the company at the time of the initial public offering, the investing public may perceive their actions as a "bailout," which could have adverse implications on the proposed offering. The success of the offering—and of the company—depends upon the integrity, experience, and commitment of management.

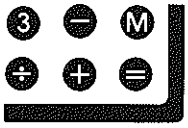
If the investment banking firms are satisfied with the results of their investigations, they will be in a position to have definitive discussions about the proposed initial public offering with the company.

At the same time, the company should have the answers to questions about the qualifications of the investment bankers. If an investment banking firm does not meet all of the requirements, a comanaged underwriting may be considered. For example, a comanaged arrangement may be considered beneficial by the CEO if the company wants an investment banking firm that specializes in the company's business and another firm that has a strong institutional customer base; one investment banking firm may not be able to satisfy both criteria. From the investment bankers' perspective, the comanaged underwriting arrangement may be less desirable because it requires splitting the underwriting commission.

for offering common stock. Additionally, common stock has no mandatory interest or dividend payment requirement.

One measure used to determine the stock value and price is industry ratios

A number of variables enter into the investment banker's approach to determining the price of the stock to be offered. No one formula is used. The investment banker first values the entire high technology company. The value is determined in large part by comparing the company to similar public companies in the industry. To value the company, the investment banker projects what effect an infusion of capital from the proposed offering will have on financial position and operating results. Then the investment banker compares the projected financial statements of the company to those of similar-sized public companies, placing emphasis on assets, revenues, and earnings. Key financial ratios used within the industry include the following:



—Leverage ratios—debt to equity, number of times interest earned
—Earnings ratios—net earnings as a percentage of sales, net earnings to net worth, net earnings as a percentage of assets
—Efficiency ratios—sales per employee

In most cases, the investment banker acknowledges that exact comparisons cannot be made and, therefore, takes into account certain factors, including the following:
—Experience and quality of management
—Product innovations and/or track record of research and development successes
—The length of time the high technology company has been in operation—an operating history
—Historical and projected growth rate of sales and earnings
—Operations base—regional, national, or international

Once the investment banking firm identifies comparable public companies and considers the similarities and differences, it reviews the companies' price-earnings ratios and determines the approximate market value of the company, often ideally in the range of $30 million to $40 million for an initial offering. Depending on the stage of the life cycle and the degree of risk, the underwriters usually recommend selling 25 percent to 33 percent of the high technology company in the initial public offering.

Underwriters typically set price per share between $10 and $20

The managing underwriter will most likely recommend that the company price its shares between $10 and $20. The underwriter may advise that stock priced below $10 would be viewed by the public market as speculative, and stock priced above $20 would dissuade individual investors from buying because of the higher purchase price of a round lot of, for example, 100 shares.

The managing underwriter may also recommend that the exact offering price be set at 10 percent less than the anticipated aftermarket price. The selling shareholders' desire for the highest offering price may therefore not serve the best interests of the emerging high technology company. If the investing public perceives the initial offering price of the stock to be too high, the result may be a weak aftermarket.

Once the investment banker has estimated the value of the company and has arrived at a share price, the company may have to adjust the number of shares it authorized before the offering. This can be accomplished either through a stock split or through a reverse stock split. The managing underwriter will advise the company to offer enough shares to obtain a broad distribution in order to provide liquidity in the aftermarket and to interest institutional investors. Institutional investors typically make their purchases in blocks of 10,000, 20,000, and 50,000 shares. Most underwriters consider a minimum offering of 750,000 shares to be acceptable.

A review of the company's financial statements is a positive step toward laying financial groundwork *and* reducing the cost of an audit at a later date

At a minimum, the CEO should consider, in the earliest years, retaining the accounting firm to perform a review (defined by professional standards, not a full audit) of the company's financial statements *and to observe physical inventories.* By taking this step, the CEO will have laid the necessary groundwork to expand the review into an audit if it is needed in the future and, at the same time, will have postponed the costs of an audit. The CEO should also bear in mind that the costs of performing the audit at this time will be lower than if the audit were performed at a later date.

Furthermore, the CEO should note that the SEC requires audited financial statements for significant unconsolidated subsidiaries and businesses that the company has acquired. Significance is based on a total assets and earnings test defined by SEC rules and regulations. Management's inability to present this information in the financial statements may delay taking the company public until that time when management can provide the required audited financial statements.

The CEO's strategy should include working closely with the accounting firm to ensure that financial information is complete for the three to five years prior to taking the company public.

- *Analyzing tax exposure.* Before going public, the CEO and management should analyze tax exposure and make appropriate changes.



Because of the disclosure requirements in financial statements, the public company's tax practices will become visible. Additionally, disputes with federal and state taxing authorities may also be disclosed in financial statements. The CEO should keep in mind that claims by taxing authorities may cast a negative light on the company.

Seeking counsel and advice from experienced tax professionals will help the CEO to develop a strategy for minimizing taxes as a public company.

Role of the Accountants

Once the decision to go public has been made, the accountant's role in assisting the CEO includes:

- *Assisting with the preparation of the financial data and auditing the financial statements.* During this process, the accountant will advise the CEO on SEC regulations and acceptable accounting principles within the industry. (At the time of the initial public offering, the company is given the one-time option under the accounting profession's rules to retroactively change accounting principles.)

- *Reviewing the financial data and related disclosures in the registration statement for completeness.* This is an extremely important step in the registration process. The SEC has very strict requirements regarding disclosures of financial information about the company in the registration statement and prospectus. An accountant experienced in SEC matters can anticipate and address possible SEC concerns before they are raised, thereby avoiding possible delays.

- *Furnishing a comfort letter to the underwriter.* Before the registration statement becomes effective, the underwriters will require some assurance from the accountant about the numbers presented in the registration statement. To prepare a comfort letter on those numbers, the accountant traces the numbers in the registration statement to reports, general ledgers, and detailed schedules, thereby providing the underwriter with "comfort" about the financial data included in the registration statement.

terms of all contracts—leases, employment contracts, stock option plans—with related parties. The SEC defines related parties as principal owners, management and members of their immediate families, equity investors, and registrants' affiliates.



- Assisting management with underwriter negotiations.
- Monitoring closely the activities of the high technology company during the period between the filing and the effective date.

Legal counsel plays a pivotal role in the initial public offering of a high technology company. Because of the complex legal considerations in registering securities and the consequences of becoming a public company, the CEO will be dependent on SEC counsel.

Selecting the Attorneys

Selecting an attorney with SEC law experience is crucial

Selecting an attorney with SEC law experience is critical. If the company's present counsel is not qualified in securities law, then the CEO can ask the present attorney to recommend another firm, or the CEO may seek recommendations from the accountant, the commercial banker, companies in the industry, or investment bankers. Using a law firm that specializes in SEC matters for the purpose of the initial public offering should not necessarily affect the relationship with the present attorney, who can continue to perform other legal services.

Once the CEO has obtained introductions to law firms qualified in securities law, selection can be based on the reputation of the firm, the experience of the individual lawyers to be involved in the initial public offering, and personal compatibility.

Underwriter's Counsel

The underwriter will also be represented by legal counsel. The underwriter's counsel will assist in performing due diligence, reviewing the registration for compliance, and drafting and reviewing the agreement between the underwriter and the company. The underwriter's counsel and the company's counsel will work closely together throughout the process of going public.

The Printer

Selection of a qualified, experienced financial printer is important to a successful initial public offering. All printers are not experienced in meeting the printing specifications of a registration statement to be filed with the SEC. Only a select group of financial printers understand the registration process and can handle the work.

Selection of the printer can be postponed until after the CEO has chosen SEC counsel and the underwriter. Because of the experience that accountants, attorneys, and underwriters have with registration statements, the CEO should consult with these professionals before selecting the printer.

Communications Strategy

A soon-to-be public company must develop an effective communications strategy and public image. The desirable public image motivates investors to purchase shares, and it motivates investment analysts to recommend investment in the securities.

The right corporate image is extremely important

Underwriters and analysts will look at the corporate image in making their decision to influence the buying public. While the SEC imposes strict regulations on the use of publicity and advertising during the registration process, the CEO will find that name recognition may affect the pricing of the stock and the acceptance by the public. As are accounting and law, communications is a specialized field. The CEO may want to engage a marketing communications consulting firm to assist with a corporate communications strategy, a program for the company's image, investor relations, media relations, product positioning and advertising, and trade relations.

In Summary . . .

Perspective: The CEO

The Sequence of Events:
- ► Selecting the professional advisers
- ► Drafting the registration statement
- ► Printing the prospectus
- ► Filing with the SEC
- ► Waiting (SEC review)
- ► Going effective
- ► Closing

The Underwriters:
- ► Selecting the underwriter
  - — Types of underwritings
  - — Offering price

The Accountants:
- ► Role of the accountants
- ► Selecting the accountants

The Attorneys:
- ► Role of the attorneys
- ► Selecting the attorneys

Underwriter's Counsel

The Printer

Communications Strategy

The Cost of Going Public

If I Go Public—

How Do I Assess My Management Team and My Board of Directors?

chapter four

The Board of Directors

Underwriters and investors will be looking for a board of directors made up of the right people—including the right outside people. The CEO and the investors must be able to attract well-positioned board members who can assist the company in formulating policy decisions and strategies for growth.

The Business Plan

Elements of the business plan are also key components of the registration statement

Underwriters and investors will be looking for a sound business plan describing the technology, the product, the market, the operations, the people, and the financing needs. How the objectives and activities of the plan are orchestrated, so that the company reaches the public market and achieves projected levels of growth, must be clearly understood by the CEO. The CEO and the management team will be spending long hours developing and refining the business plan. Later, during the registration process, they will recognize the benefit of time spent on the business plan because many elements of this plan become critical components of the registration statement.

The Compensation Strategy

The compensation strategy must attract, retain, and motivate key management members

The CEO who has developed a strategy for attracting an outstanding management team will also want to develop a strategy for retaining the team. The company that goes public and expects to compete must devise a compensation strategy that attracts, motivates, and retains talented executives.

Most executive compensation programs include four categories of compensation: current compensation, deferred salary and supplemental income, capital accumulation plans, and qualified deferred compensation plans. While specific executive compensation packages may emphasize one category or another, most include all or a combination of the categories:

- *Current compensation*—base salary plus such other current compensation as bonus or incentive compensation, usually tied to short-term performance objectives.
- *Deferred salary and supplemental retirement income*—arrangements that allow executives to defer the receipt and taxability of a portion of their current compensation, and plans that allow the executive to receive supplemental retirement income if specific conditions are met within specific future time frames.
- *Capital accumulation plans*—awards that provide executives with the right to receive cash, the right to receive or acquire capital stock, or the right to receive and/or acquire a combination of cash and capital stock as consideration for performance of personal services. Because of management's desire to design and implement plans that are responsive to the objectives of both the company and the executives, the types and characteristics of capital accumulation plans have, over the past years, become increasingly complex. The design of these plans requires a thorough understanding of all the objectives, as well as a thorough understanding of relevant accounting principles and current tax laws.
- *Qualified deferred compensation arrangements*—funded pension and profit-sharing plans in which substantially all full-time employees participate.

Comprehensive Personal Tax Strategy

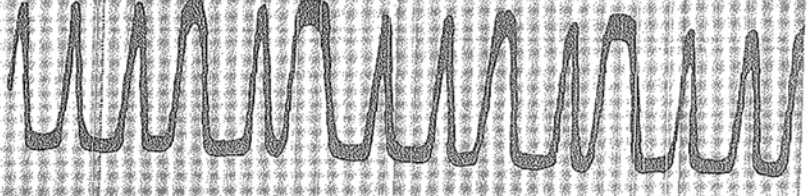
Additionally, because the market value of the shares of a company increases when the company goes public, major shareholders involved in an initial public offering should seek advice on developing a comprehensive personal tax strategy. The strategy should address these matters:

- Timing and tax ramifications of exercising stock options for a publicly traded company

chapter five

If I Go Public—

What Are the Critical Steps?



Form S–18 is tailored to the special needs of emerging high technology companies. It enables the company to get quicker, easier access to capital markets, and it reduces the number of financial disclosures required. Form S–18 permits the gradual three-year phasing in of the more complex financial reporting requirements associated with Regulation S–X. In contrast, the earlier form, Form S–1, requires compliance with Regulation S–X at the time of the filing of the registration statement.

Regulation S–X governs the form and content of *financial information*

Regulation S–X dictates the form and content of the financial statements presented in the registration statement. The accountant will play an important role in assisting the CEO and management in meeting the stringent requirements of Regulation S–X.

Form S–X also governs the disclosure of some nonfinancial information. Whether the company applying for the registration of its securities uses Form S–1 or Form S–18, the requirements for disclosure of nonfinancial information remain basically the same.

Regulation S–K dictates the form and content of *nonfinancial information* included in the registration statement

Regulation S–K presents the requirements for the inclusion and presentation of nonfinancial information in Part I of the registration statement—the prospectus. While the CEO and the company's management team have primary responsibility for the information that is presented in the prospectus, its SEC counsel will typically assist in preparing the nonfinancial information, and its accountants will assist in reviewing the financial information required by Regulations S–X and S–K.

The CEO and the registration team evaluate the use of either Form S–18 or Form S–1

Generally, Form S–18 offers the following advantages over Form S–1:

- Expediency of filing in the regional office of the SEC versus filing in the Washington, D.C., office
- Requirement for two years of audited financial statements (or since inception if less than two years) versus three years of audited financial statements (or since inception if less than three years), as required by Form S–1
- Application of generally accepted accounting principles (GAAP) in presenting financial information rather than the more detailed Regulation S–X requirements of Form S–1
- Opportunity for the registration team to meet with the SEC staff before filing, if it so wishes
- Reduction in the number of operational and financial reporting requirements as compared to S–1 requirements

Depending on the size of the offering, the CEO and the registration team will weigh the advantages and disadvantages of using Form S–18 rather than Form S–1 in its initial public offering. In either case, the company's accountant and attorney will serve as valuable resources in reaching a decision.

Drafting the Registration Statement

The '33 Act also governs the content of the registration statement. The SEC expects the company not only to comply with the applicable required disclosures, but to provide potential investors with further disclosures that the company believes are germane to an investment decision.



► *Selected financial data.* Summarized financial data are required for each of the last five years or since inception, and comparatively for any interim period since the last year-end and the corresponding period of the preceding year. The purpose of this information is to highlight certain significant trends in the financial condition of the company and the results of operations. Financial data for periods other than those required should be presented if necessary to keep the information from being misleading.

► *Management's discussion and analysis of financial condition and results of operations.* This discussion and analysis should promote investor understanding of the high technology company by providing information on trends in the company's operations, liquidity and capital resources, commitments, expected sources of capital, and future plans. The discussion should relate to the last three fiscal years, but may include additional periods, if meaningful.

This section must include all details about the operations of the company

► *The business.* A detailed description of the business is required. The principal disclosures must include information concerning:

— General development of the business over the last five years or since inception
— Operating plan for the following year if the company has not had operating revenue for all of the last three fiscal years
— Financial information relating to industry segments
— Principal products produced and services rendered by each industry segment
— The principal markets and distribution method for each industry segment's principal products and services
— The status of new products or industry segments about which public announcements have been made
— Sources and availability of raw materials
— The importance, duration, and effect of patents, trademarks, licenses, franchises, and concessions held
— The extent to which the business is, or may be, seasonal
— Practices relating to working capital items (such as required inventory levels to meet customer needs, customer rights to return merchandise, and extended payment terms)
— Dependence on a customer or a limited number of customers
— Dollar amount of firm order backlog
— Government contracts subject to renegotiation or termination
— Competitive business conditions
— Research and development expenditures during each of the last three fiscal years
— Any material effects or costs associated with compliance with environmental protection laws
— Number of employees
— Financial information about foreign and domestic operations and export sales for each of the last three fiscal years
— Description of properties
— The status of any significant legal proceedings that are pending

► *Management and certain security holders.* This section requires the company to provide background information on its directors and principal officers with respect to such matters as:

— Their business experience
— The amount of their direct and indirect compensation, including information about stock options, profit sharing plans, and other benefits

Due Diligence

The company has absolute liability for not correctly stating — or for omitting — the required disclosures in the registration statement. All other parties associated with the registration statement can avail themselves of a "due diligence" defense against this liability. Due diligence consists of an investigation of all statements made in the registration statement that will provide a reasonable basis for the persons conducting the investigation that the statements made in the registration statement are true and do not omit any information that could lead to the statements being misleading.

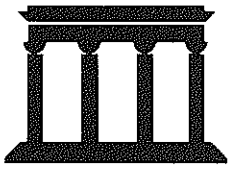
Because the registration statement is *so closely analyzed,* all parties involved must read the *entire document*

Misstating or omitting required disclosures in a registration statement, filed in compliance with the '33 Act, can result in both civil and criminal prosecution. The upper limit of the civil liability could be as high as the sales proceeds of the shares issued. This liability could apply to all the directors and to each officer who signed the registration statement, and also to the company, the underwriters, and all experts associated with the registration statement, including the auditors, legal counsel, and other professionals.

It is important that all parties involved in the preparation of the registration statement read the entire document. The SEC counsel and underwriter's counsel will conduct an intensive investigation of the company and will scrutinize the registration statement text in carrying out their due diligence procedures. The underwriters will normally request a comfort letter from the independent accountants. This comfort letter details the procedures that the accountants have followed. The letter primarily covers unaudited financial data in the registration statement. The underwriter will also request an opinion letter from the company's counsel regarding the company's corporate status, the legal validity of the stock being issued, and the conformity of the registration statement with SEC rules.

Filing with the SEC

When the registration statement is completed and all parties associated with the drafting and review are satisfied, it is filed with the SEC. The registration statement must be signed by specific officers and a majority of the board of directors.



A preliminary prospectus is printed and then distributed to the underwriting syndicate. This preliminary prospectus will not have a final offering price, but will include an offering price range. The preliminary prospectus is also known as a "red herring" because it must have the following statement, printed in red ink, on the front cover:

"A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not become effective. Information contained herein is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such state."

SEC Review

The SEC does not comment, in any manner, on the merits of the offering

The registration statement is reviewed by the SEC Division of Corporation Finance. The division's staff is made up of accountants, attorneys, security analysts, and engineers. All initial public offerings are given an in-depth review by the division's staff. The purpose of the review by the staff is to ensure that all of the appropriate disclosures are made in the registration statement. The staff does not comment in any manner on the merits of the offering, nor does the fact that the SEC declares an offering effective imply SEC approval.

Filing Under "Blue Sky" Laws and with NASD

In addition to filing a registration statement with the SEC, the company must qualify the securities to be offered under the "blue sky" laws, which are the individual states' securities laws. (The term "blue sky" refers to pervasive fraud schemes of the early 1900s. The result of these fraudulent schemes was the enactment of states' "blue sky" securities laws.)



The primary difference between the state laws and the '33 Act is that many of the state laws pass on the merits of an offering. The state laws allow for a prohibition of the sale of a security in a given state, even if all the required disclosures have been made. Some state authorities will take exception to related-party transactions, particularly those involving the issuance of stock and stock options, "excessive" dilution for public investors, "excessive" management compensation, and too many outstanding options, among other things. The underwriters will be able to determine in what states the securities will be sold, and the underwriter's counsel will coordinate the filings in each of those states.

In addition, the National Association of Securities Dealers, Inc. (NASD) will determine if the underwriting arrangements are fair and reasonable. Before the registration statement can be declared effective, the NASD reviews the underwriting discount and all other forms of compensation to be received by the underwriter in connection with the offering, and gives clearance. Underwriter's counsel will coordinate this review.

Waiting and Preliminary Marketing

Prior to the initial filing of the registration statement, no public offering of the securities is permitted, either orally or in writing. Also, if publicity about the company stimulates an interest in the securities, even if the securities themselves are not mentioned, the publicity about the company or its products could be considered a violation of SEC laws and thus force a delay of the offering.

During the waiting period, no sales and only preliminary marketing are permitted

During the waiting period, the interval between filing with the SEC and the effective date, the company and the underwriters may distribute preliminary prospectuses.

During the waiting period, only preliminary marketing efforts are permitted. No written sales literature is permitted other than the preliminary prospectus. Through the use of a preliminary prospectus and by making oral solicitations by telephone or otherwise, the underwriters may offer the security and may accept "indications of interest" from purchasers prior to the effective date. However, no actual sales can be made during the waiting period.

The SEC is sensitive to all public statements made by the company during the waiting period. The company should discuss with its SEC counsel and managing underwriter all press releases before they are issued.

The Road Show

As part of the selling effort, the managing underwriter will arrange for a series of meetings to be held in various cities to promote the offering. This tour is referred to as a "road show." It takes place shortly after the initial filing of the registration statement and can cover as many as ten cities in the United States, as well as selected cities in foreign countries. *The purpose of the road show is to sell the potential of the company and to display the abilities of the management team.* These meetings are a unique opportunity to tell the story behind the growing company and its product.



Developing the Timetable

From the "all-hands" meeting to closing the deal, the registration team, composed of the CEO, the company's management team, the underwriters, and the professional advisers, will work intensively—drafting the registration statement, filing with the SEC, filing under "blue sky" laws and with NASD, and going effective. The timetable that the registration team set at the beginning of the process will have played a significant role in meeting the requirements at each critical step in the process of going public.

The timetable below serves as a typical set of activities of a company applying to the SEC. The CEO and the registration team of the hypothetical company have elected to use Form S-1 as the appropriate method of application.

Advanced Technology Corporation: A Hypothetical Company

Advanced Technology Corporation, a hypothetical high technology company, proposes to go public. The timetable on the following pages illustrates the proposed time and responsibility schedule for the key people involved in taking the company public. In the example, the first "all-hands" meeting was held on June 10, with a target filing date of July 15 and a target offering date of August 28. The example assumes that all of the corporate housekeeping is completed and the necessary audits performed.

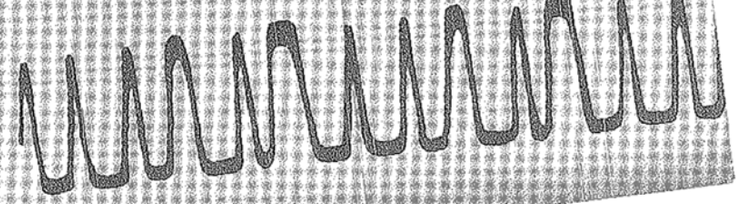
Advanced Technology Corporation: Initial Public Offering: Proposed Time and Responsibility Schedule

Parties Involved:	Advanced Technology Corporation	ATC
	Selling shareholders	SS
	Company's SEC counsel	CC
	Underwriters	U
	Underwriter's counsel	UC
	Accounting firm	A

Tentative Date	Activity	Responsibility
June 10	Organizational "all-hands" meeting to discuss parameters of offering, schedule, prospectus format, and responsibilities: due diligence.	All
June 20	A first draft of prospectus distributed.	ATC/CC
June 24–25	Drafting session; due diligence meetings: customer and supplier lists available.	All
Week of June 23	Preparation of draft underwriting agreement; agreement among underwriters; power of attorney; underwriters' questionnaire; officers', directors', and selling shareholders' questionnaires; and preliminary "blue sky" memorandum.	UC

Tentative Date	Activity	Responsibility
Week of July 27	Domestic road show.	ATC/U
	Underwriters' information meeting.	ATC/U
	Prepare underwriters' advertising.	U
	Review market conditions.	ATC/SS/U
	Complete "blue sky" qualification.	UC
	Accountants deliver draft of the comfort letter.	A
Week of August 5	European road show.	ATC/U
Week of August 26	Receive comment letter from SEC, review SEC comments, and prepare responses.	All
	Acceleration requests.	ATC/SS/U
	Distribution report from underwriters.	U
August 27	Pricing meeting.	ATC/U
	Final due diligence meeting.	All
	Prepare pricing amendment.	CC/UC/A
August 28	Execute underwriting agreement and agreement among underwriters.	ATC/SS/U
	File final amendment.	UC/CC
	Accountants deliver comfort letter.	A
	SEC declares issue effective; commence public offering.	U
	Issue final press release announcing offering.	ATC/U
	Supplemental "blue sky" memorandum distributed.	UC
	Complete "blue sky" and NASD filings.	UC
August 29	File ten prospectuses with SEC.	CC
September 1	Underwriters provide a listing of purchasers for stock certificates.	U
	Registrar and transfer agent authorized to deliver stock certificates for inspection.	ATC
September 3	Preclosing.	CC/UC
	Certificates available for inspection.	CC
September 4	Closing. Payment and delivery; accountants' delivery of updated comfort letter; execution of other closing documents.	All

chapter six





- *Form 8–K,* which must be filed within 15 days of (1) a change in control, (2) the acquisition or disposition of a significant amount of assets not in the ordinary course of business, (3) bankruptcy or receivership, (4) changes in independent accountants, and (5) certain resignations of directors. The company, at its option, may also report any event or events that the company deems of importance to security holders.



- *Form 10–Q,* which must be filed quarterly within 45 days after conclusion of each of the first three quarters. This report contains unaudited quarterly financial statements, management's discussion and analysis, and disclosure of certain specific reportable events, such as a change in accounting principle. In addition to disclosing a change in accounting principle in Form 10–Q, the company must also obtain a letter from its independent accountant indicating whether the change applies to an alternative principle that in the accountant's judgment is preferable under the circumstances.



- *Form 10–K,* which must be filed annually within 90 days of the fiscal year-end. Form 10–K is designed to update, on a continuing basis, the disclosures in the registration statement. Accordingly, Form 10–K includes the latest audited financial statements and a somewhat condensed version of the information disclosed in Form S–1.

As a public company, management must meet all of the requirements and due dates for these periodic reports. Failure to do so could result in adverse consequences for the company.

Proxy Solicitations

As the CEO will learn, selected events during the life of a public company require a vote by the shareholders. Examples of such events may be the election of directors and approval for major acquisitions or divestitures.

When decisions require a vote by the shareholders, assembling all of the shareholders may not be practical. The process and timing of voting on decision-making issues by shareholders are defined by SEC proxy rules, individual state requirements, and corporate bylaws. The company will solicit from the shareholders the authority to vote their shares at a meeting. The SEC's proxy rules specify the content of the proxy statements that are used in the solicitation process.

The proposed proxy statement must be filed with the SEC ten days prior to the date that the proxy materials will be mailed to shareholders.

In addition to a proxy statement, in connection with an annual or special meeting, the company is required by SEC rules to send a copy of an annual report to each shareholder. The SEC specifies the content of the annual report.

Tender Offers and Reports by 5 Percent Shareholders

The SEC regulates both the manner in which tender offers for any class of securities can be made and the tactics management may employ to resist a tender offer. If any person acquires a 5 percent or more equity security interest in the company, he or she is required to file prescribed forms.

a person who owns fully paid restricted stock for at least two years to sell during any three-month period the greater of the following:

- One percent of the securities of that class outstanding
- The average weekly reported volume over a four-week period of trading for the securities on all national exchanges or reported on NASDAQ

Rule 144 is extremely complex—one should seek SEC counsel

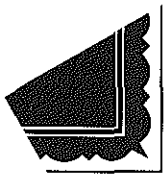
If sales of restricted stock within a three-month period either exceed 500 shares or have an aggregate sales price of more than $10,000, then a Form 144 must be filed with the SEC.

Persons who are not controlling shareholders and have owned fully paid restricted stock for a period of three years or more are not subject to any of the resale restrictions of Rule 144.

The provisions of Rule 144 are complex and subject to constant interpretation. SEC counsel should be consulted before any Rule 144 sales are made.

Listing Securities on a Stock Exchange

CEOs offering their companies' securities for sale in the public marketplace may seek a listing on the New York and American stock exchanges. However, these exchanges have specific listing requirements, and few emerging high technology companies can meet these requirements immediately after an initial public offering.



Instead, emerging companies completing their initial public offerings often list their securities in an over-the-counter market. The NASDAQ system, sponsored by the National Association of Securities Dealers, is such a system. It provides the benefits of electronic price quotations and trading volume information for a significant number of over-the-counter securities. The NASDAQ over-the-counter markets have grown rapidly in recent years. Most major newspapers publish the NASDAQ national listing of securities, and total NASDAQ trading volume has been very significant. Many NASDAQ-traded companies in fact may prefer to remain on the NASDAQ over-the-counter market.

In Summary . . .

Perspective: The CEO

The Value of the Stock

The Use of Proceeds

Periodic Reporting

Proxy Solicitations

Tender Offers and Reports by 5 Percent Shareholders

Insider Reporting and "Short Swing" Profits

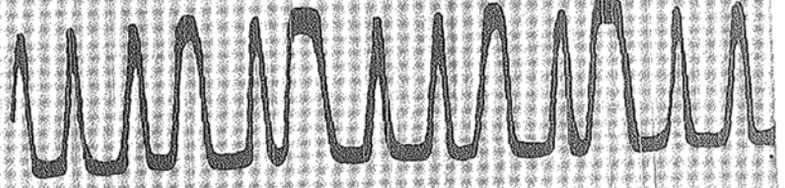
Rule 144: Resale of Restricted Securities

Listing Securities on a Stock Exchange

chapter seven

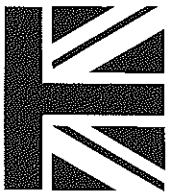
The Foreign Exchanges—

What Are the Opportunities for Going Public Outside the United States?



The objective of the following interviews is to provide you with an overview of some of the foreign equity markets and the opportunities for U.S. high technology companies seeking equity capital. A word of caution. . . these foreign markets are very dynamic and subject to changing conditions. . . . Thus, it is strongly encouraged that you contact your local Peat Marwick professional to explore in detail the current opportunities of foreign equity markets and the advantages and disadvantages they possess vis-à-vis going public on U.S. exchanges.

The London Stock Exchanges



CEO: What are the advantages of going public in the United Kingdom versus the United States?

KPMG, London: The London public markets offer a number of distinct advantages. First, there are fewer and less stringent regulatory requirements, both in relation to the initial offering and the ongoing reporting requirements. Second, the costs of entry are lower. The main market is designed for companies with a market capitalization of greater than approximately $20 million, but the junior unlisted securities market is designed for companies capitalized at between only $5 million to $40 million. Smaller, young high technology companies can list on the junior market. Many of these companies are high technology companies.

CEO: What are the markets for selling shares in the United Kingdom?

KPMG, London: The United Kingdom has two distinct public markets* for selling shares: the Stock Exchange Listed Securities Market, a full listing of the traditional market for the securities of 2,000 U.K.- and 500 foreign-listed companies, as well as U.K. and foreign government stocks; and the Stock Exchange Unlisted Securities Market (USM), a junior market used by over 400 companies since its inception in 1980. This market has proved particularly attractive to developing companies. It was established to simplify entry procedures and minimize the cost of listing.

CEO: Are the roles adopted by professional advisers in the United Kingdom different from those adopted by advisers in the United States?

KPMG, London: Entering the London markets requires a coordinator known as a sponsor, in addition to a stockbroker, an accountant, a tax adviser, a solicitor, and possibly other advisers.

The role of sponsor is usually filled by an investment banker or a stockbroker. The sponsor plans the entry to the market, draws up the timetable, offers advice about documents, and assists in pricing shares. The sponsor makes sure that the high technology company is fit to be brought to market, a responsibility that is taken seriously.

All applicants for entry to the stock exchange markets will require the services of a sponsoring stockbroker to liaise between the company and the stock exchanges. The stockbroker will deal with the formalities of application and will advise on price and marketing. He or she is the link between the investment community and the company.

*The new Third Market was launched in January 1987. The market's objectives are to provide an accessible marketplace for young, emerging companies to raise capital. Its entry and annual fees are substantially lower than those of the other two markets.

CEO: What continuing obligations will my emerging high technology company have if I go public on the London markets?

KPMG, London: At present, the markets in the United Kingdom have no equivalent of the SEC in the United States. The markets are essentially self-regulated, more flexible, and have fewer regulatory requirements. However, under certain circumstances, the U.S. high technology company entering the London markets may have to register with the SEC. For example:

- If securities are issued in London by a U.S. company but are not offered for sale to members of the general public in the United States, they need not be registered under the U.S. Securities Act of 1933.

- If, however, the U.S. company has assets exceeding $5 million and a class of equity securities held by 500 or more shareholders, the periodic reporting requirements of the U.S. Securities Exchange Act of 1934 will apply regardless of the residence of those shareholders. It may be possible under certain circumstances to apply for an exemption from this requirement.

- If a U.K. holding company is formed for the U.S. operations, the requirements of the U.S. Securities Exchange Act of 1934 will be triggered only if the $5 million in total assets and 500 total shareholders criteria are met and, in addition, if 300 or more shareholders reside in the United States.

Obviously, these matters require careful consideration before proceeding with an issue of securities.

If the company is subject to SEC requirements, then disclosure becomes another issue. The SEC requires the company to present its financial statements in accordance with U.S. generally accepted accounting principles (GAAP) and to make other financial disclosures.

Other continuing obligations include sending annual audited financial statements, interim reports, and circulars to shareholders, and adhering to "insider dealer" restrictions on transactions. However, these will apply to all companies obtaining a listing on the London markets.

CEO: What about taxation?

KPMG, London: While the circumstances of each company entering the London markets differ, generally the London public markets do not expose the U.S. company to U.K. tax. The United Kingdom assesses corporation tax only on those companies that are resident in the United Kingdom, that are operating in the United Kingdom through a branch or agency, or that have U.K.-source income.

CEO: Does pricing differ in the United States and the United Kingdom?

KPMG, London: Yes. The amount of money raised from a given issue of shares will differ; the market conditions differ; industry segments differ. Thus, pricing differs. The

CEO: What are the requirements of a public offering in Vancouver?

KPMG, Vancouver: The primary requirement of a company seeking an initial public offering is the preparation of a technical report to support the prospectus. This report is essentially a highly detailed business plan that must be prepared when the company is undertaking an initial public offering to launch a new product or service, or when it plans to enter a new field. The report must include an assessment and evaluation of the product, service, or technology, as well as an evaluation of a marketing plan. A qualified, independent person prepares the report.

CEO: Should the emerging high technology company raise seed capital before listing on the VSE?

KPMG, Vancouver: Yes. Before listing on the VSE, the emerging high technology company must raise $150,000 in seed capital through a one-time sale of securities to an unrestricted number of purchasers. The proceeds go toward financing the development of the company's business. The company need not prepare a prospectus for this initial sale.

CEO: What are the phases of going public on the VSE?

KPMG, Vancouver: During the process of going public, the young high technology company will progress through four phases, each requiring considerable planning.

During the first phase, the private phase, no public trading can take place. The CEO and management will address the matters of shares issued to principals, shares issued to acquire assets, and shares issued for seed capital.

During the second phase, the prospectus phase, the prospectus will be prepared and presented to the British Columbia Superintendent of Brokers for acceptance. The prospectus will describe the company and its net assets, capitalization, plans for future growth, and plans for use of proceeds.

During the third phase, the public offering phase, the initial distribution of shares is completed.

During the fourth phase, the listing phase, the public company applies for listing on the VSE and meets specific application requirements.

Once the company has reached public status, it must abide by a network of statutory acts, regulations, and rules, all enforced by the VSE.

CEO: What are the roles of the professional advisers as they relate to going public on the VSE?

KPMG, Vancouver: The team of professional advisers includes the attorneys, the accountants, and the underwriters.

The attorneys offer assistance in capital restructuring and reorganizing before going public. They advise on and draft provisions of contractual agreements; review and write portions of the prospectus; and counsel officers, directors, and principal shareholders on the liabilities and obligations they must assume as the company goes public.

Canadian securities legislation is based on the laws of both the United Kingdom and the United States. For example, the incorporation of some of the U.S. "blue sky" provisions places a responsibility on Canadian securities administrators to ensure that an issue of securities will be in the best interests of the investor. Unlike the United States, Canada has not enacted federal securities legislation. Each province administers its own securities rules and regulations.

CEO: How does an emerging high technology company list shares on the TSE? Who takes the lead? And, what are the roles of the securities dealers, the attorneys, and the accountants?

KPMG, Toronto: To complete a successful IPO and listing of shares through the TSE, the company must be sponsored by a TSE-member securities dealer. Taking the lead role, the sponsoring securities dealer is obligated to conduct a thorough study of the company, its management, its owners, and its track record.

The sponsoring securities dealers, or underwriters, agree to underwrite the securities on either a "firm commitment" basis or an "agency," or best-efforts, basis. Under the firm commitment, the dealer contractually agrees to purchase the securities from the company at a negotiated price, and then resells them to the public for profit. Under an agency agreement, the dealer uses his or her best efforts to sell the securities for a commission, but is under no obligation to the company if investors show insufficient interest in the securities offered.

The attorneys play a major role in Canadian securities offerings. While the company may draft parts of the prospectus, the company's attorneys and the underwriter's attorneys assume a major role in writing the prospectus, in order to ensure that it meets requirements set out in Canadian securities legislation, and to ensure that it meets the general standard of "full, true, and plain disclosure." One of the legal firms—the company's or the underwriter's—will assume the primary role of responding to comments that individual provincial securities commissions and the TSE have made about the company's prospectus. Legal experience in the complexities of Canada's securities laws is extremely important in fulfilling this role.

In Canada, as in the United States, the accountant assumes the role of assisting the company in the preparation, review, and/or audit of the financial information in the prospectus. Securities legislation requires that the annual financial statements presented in the prospectus be audited. Interim financial statements presented in the prospectus need not be audited, but the accountant must perform certain procedures that enable him or her to provide a letter of comfort on the statements to the securities administrators. The accountant may also be asked to provide the appropriate accountant's report to accompany such other financial information as pro forma financial statements and financial forecasts.

CEO: Once I make the decision to file an exchange-offering prospectus with the Toronto Stock Exchange, what are the disclosure requirements?

KMPG, Toronto: Regulations applying to the various provincial securities acts specify disclosure to be made in the prospectus. The company is required to disclose information about each of the following items:

- Use of proceeds
- Share and loan capital structure

- Annual audited financial statements to be filed within 140 days of the year-end
- Proxy solicitation and information circulars
- Insider trading reports from directors, senior officers, and principal shareholders
- Special reports from substantial shareholders—those holding 20 percent or more—who intend to sell any portion of their shareholdings

Annual sustaining fees, depending on the size of the company, may be based on the number of shares listed or on the market value of the company's listed securities.

CEO: Do nonresident corporations pay taxes in Canada?

KPMG, Toronto: Generally the answer is "no"—unless the corporations carry on business in Canada. For those companies that do carry on business in Canada and are taxed, the rates range from 40 percent to 50 percent, depending upon the nature of the business.

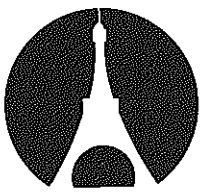
CEO: How is pricing determined?

KPMG, Toronto: In Canada, pricing, size, and nature of the issue are negotiated by the sponsoring securities dealer and the company. Although Canadian markets have been receptive to high technology companies, market conditions do vary in a single year. Therefore, valuation and terms are often a matter of timing.

The Paris Stock Exchanges

CEO: Activity on the French capital markets has shown a sharp increase in recent years. Is this true of foreign stock dealings on the Paris stock exchanges?

KPMG, Paris: Yes. Some 225 foreign companies are listed on the Paris stock exchanges.



CEO: What are the differences among the over-the-counter market, the second market, and the official market?

KPMG, Paris: The over-the-counter market has fewer disclosure requirements, simpler filing procedures, and is used by companies seeking a market for their shares outside the official market or the second market. However, few transactions are registered on this market and it should only be recommended for a foreign company that cannot meet the listing requirements of the official market or the second market.

The second market, set up in 1983, promotes emerging, high-growth companies. Established to list less mature companies that cannot meet eligibility requirements of the official market, it now lists more than 100 companies, 4 of them in foreign countries. However, this market should only be used as a transition by foreign companies until they are able to meet the requirements of the official market.

The official market is the most formal and prestigious market in Paris. It has stricter disclosure requirements than the other two markets, and is the most appropriate market for foreign companies with strong financial positions.

CEO: Does listing on the Paris stock exchanges benefit the growing high technology company that is looking for an international strategy?

business, market, and ownership of the company. Based on a preliminary study, the COB makes a recommendation to the Ministry of Economy as to whether the application for listing should proceed. This stage typically does not require any expense on behalf of the company.

If the preliminary approval is granted, the company will proceed with the formal listing application. Simultaneously, a listing is filed through the sponsoring bank with the CSAC and the COB. The listing application contains a draft prospectus, undertaking letter, and tentative timetable. The draft prospectus contains material similar to the prospectus published in connection with a public offering of securities in the United States. The CSAC reviews the application for listing in detail and makes a recommendation on the application to the COB. In light of the CSAC's recommendation and based on its own investigation, the COB makes the final decision affirming or denying listing and selects the market on which the stock is to be listed. If the company is unable to meet the listing requirements for either the official or second market, the COB may propose that the company's stock be traded on the over-the-counter market until the company is able to meet the listing requirements for either of these markets.

CEO: How does the sponsoring bank fit into the approval process?

KPMG, Paris: Once the company has received authorization to proceed with the listing, the sponsoring bank registers articles of association with the Paris Commercial Court; publishes a notice in the official financial press; issues a description of the high technology company; releases the prospectus to banks, stockbrokers, and investors; launches an advertising campaign; organizes a meeting with financial analysts, journalists, French investors, brokers, and bankers; and assists in placing the company's shares among French investors.

CEO: What are the ongoing filing requirements once my company lists securities on the Paris stock exchanges?

KPMG, Paris: The ongoing filing requirements (common to the different exchanges) that foreign companies seeking a listing in Paris have to commit to are to:

- Translate into French their annual reports (or relevant parts thereof), and to make such translations available to French investors.
- Publish in the French financial press any information relating to the business of the company in a way similar to that required from French companies. They must at least provide information on their business on a quarterly basis.
- Provide the French market with any information published in the other foreign markets where their shares are traded, whether on a regular basis or occasionally (especially upon any major event relating to the shares of the company).

CEO: What are the tax implications of having my company list its securities on the Paris stock exchanges?

KPMG, Paris: There is no particular implication for a U.S. company when it raises equity on the Paris stock exchanges. No capital gains tax is due on the issue of subscription rights under the France–United States double taxation agreement, and no capital transfer tax is due when the company has its headquarters in the United States.

The accountant reports on recent financial results, comments on the profit forecast, and reviews the sufficiency of working capital. The accountant also serves as the tax consultant, offering advice about the tax implications of the public issue.

The roles of notaries and attorneys in Germany resemble the role of solicitor in the United Kingdom and the role of attorney in the United States. The notary certifies the resolution of the shareholders, and the attorney gives legal advice about the issue, the documents, and the contracts.

CEO: In the case of a U.S. company seeking application to the West German market, what information is required in the prospectus? How much time will I spend drafting the prospectus and going through channels? What are the costs associated with the offering?

KPMG, Frankfurt: The high technology company should plan to spend five weeks drafting the prospectus and nearly six months meeting procedural requirements.

The prospectus must contain the following details about the company: history; description of the operations of the company; description of original capital stock, subsequent changes, nominal value, and share classification; and use of proceeds.

The costs associated with admission to trading in the official market, including trade-register fees, prospectus, legal and accounting fees, advertising and communication, printing, and commissions, may amount to 10 percent of gross proceeds. Costs for the unofficial market and the unregulated unofficial market are much lower.

CEO: Once the issue is listed, what are the ongoing requirements?

KPMG, Frankfurt: German corporation law requires German companies to publish annual reports that include audited financial statements. The foreign company is also required to publish its annual report for at least five years after the public issue.

CEO: Will I need advice about taxation?

KPMG, Frankfurt: Yes. Foreign companies planning to go public in Germany must consider both taxes paid by the company and those paid by the investors. German corporate income tax applies only to companies that are resident in Germany, are operating through a permanent establishment in Germany, or are receiving income from certain kinds of German sources. Capital gains and stock transfer may also have tax consequences.

The Amsterdam Stock Exchanges

CEO: What are the opportunities for a U.S. company to enter the public market in The Netherlands?

KPMG, Amsterdam: The Netherlands has an official market and a parallel market. To apply for a listing on the official market, a company must meet stringent requirements concerning the company's structure, organization, and disclosure. The young high technology company seeking to expand with equity capital will most likely list its securities on the parallel market, in which requirements are similar to, but less stringent than, those of the official market.

CEO: Who is available to assist me in applying to the Hong Kong stock exchanges?

KPMG, Hong Kong: The application for listing involves accountants, the underwriter or merchant bank, solicitors, translators, and real estate appraisers. While the merchant banker tends to take the lead, the accountants report on the financial statements, profit forecasts, and adequacy of working capital, as well as provide financial advice.

CEO: What is involved in drafting the prospectus?

KPMG, Hong Kong: The accountant and/or the merchant banker will coordinate and schedule the work of all of the advisers.

The prospectus, the most important document in the application process, must contain the following details:

- History and business of the company
- Information about the directors and their holdings in the company
- Rights of shareholders and a summary of the provisions of the articles of association
- Details of subsidiary and associated companies
- Statements of debt, working capital, and net tangible assets
- Statement of prospects, including a profit forecast and the accountant's report
- Five years' financial results and the accountant's report
- Real estate holdings
- Stock options
- Listing expenses
- Contracts
- Directors' interests in contracts

CEO: What factors affect the cost of the IPO on the Hong Kong stock exchanges?

KPMG, Hong Kong: The costs of listing depend on many factors—capital duty on the increased capital, the merchant banker's commission, and professional fees.

CEO: How do the responsibilities of public status in Hong Kong compare with those in the United States?

KPMG, Hong Kong: While additional requirements have been imposed following the recent unification of the stock exchanges, the rules and disclosure requirements are still less stringent than those in the United States and the United Kingdom. Generally speaking, the requirements of the Hong Kong stock exchanges resemble those of the United States and the United Kingdom, but are less onerous.

The Singapore Stock Exchanges



CEO: What markets are available to the young high technology company seeking a public market in Singapore?

KPMG, Singapore: The Singapore Stock Exchange is a prestigious market with over 310 companies listed, 190 of which are foreign. Plans are under way this year to introduce a junior securities market in Singapore modeled after the Unlisted Securities Market in the United Kingdom. Entry requirements for the junior securities market will be less demanding than those for a full listing on the stock exchange, and should present an excellent opportunity for emerging U.S. high technology companies to obtain equity capital at a lower cost.

CEO: What ongoing obligations should my company expect?

KPMG, Singapore: While the requirements of the Singapore Stock Exchange are not so extensive as those of the U.S. exchanges, the company will be expected to meet the following requirements:

- Announcement of significant developments concerning the company
- Publication of semiannual results in the local press
- Publication of an annual report for distribution to shareholders and the local press

If a company listed in Singapore is a holding company with more than 300 shareholders resident in the United States, the company will be subject to the rules and regulations of the U.S. Securities and Exchange Commission.

Additionally, as discussed earlier, a U.S. company listed on the Singapore Stock Exchange or any other foreign exchange may be subject to SEC rules and regulations if securities are offered in the United States, and if the company's assets are greater than $5 million and equity securities are held by more than 500 shareholders.

CEO: What are the tax considerations of a U.S. high technology company listing on the Singapore Stock Exchange?

KPMG, Singapore: Generally, a U.S. company listed on the Singapore market will not be subject to Singapore tax unless it carries on business operations in Singapore or it has Singapore-source income.

CEO: What should I consider in pricing the issue of the company?

KPMG, Singapore: Management should seek the help of professional advisers, accountants, or merchant bankers as soon as the company is ready to seek a public listing.

In Summary . . .

Perspective: The CEO

The Foreign Exchanges

Interviews with KPMG's High Technology Professionals in:

- London
- Vancouver
- Toronto
- Paris
- Frankfurt
- Amsterdam
- Hong Kong
- Singapore

appendixes

(3) Leasing Companies

Cost:	Usually a cost (implicit in the lease) equal to prime plus up to six percentage points; tax-advantaged leases (to the lessor) may be less expensive
Maturity:	Varies with type of asset leased; *operating* leases are short term (as short as a few months); *financing* leases approximate the useful life of the asset
Collateral:	Leasing is a form of secured lending since lessor retains title to the asset
Generally used for:	• Machinery and equipment • Real estate • Acquisition financing
Advantages:	• Easy to deal with • 100 percent of cost of asset can be financed • Risk of ownership with lessor
Disadvantages:	• Usually high cost. • Benefits of ownership, such as appreciation, are generally retained by lessor. (However, various tax benefits may be passed through to the lessee. These benefits are usually associated with additional cost to the lessee in the form of higher lease payments.)

(4) Savings and Loan Associations

Cost:	Fixed or variable rate, usually tied to long-term market rates; on working capital loans, floating, tied to the prime rate, priced competitively with local commercial banks
Maturity:	Usually long term (15 years); occasionally lines of credit
Collateral:	Almost always secured
Generally used for:	• Real estate • Occasionally for working capital and purchase of machinery and equipment
Advantages:	• Familiar, experienced lenders in real estate area • Attractive rates • Attractive loan-to-asset ratios
Disadvantages:	• Usually prefer strongly capitalized and established businesses • Careful lenders to commercial businesses for working capital needs

(5) Life Insurance Companies/Pension Funds

Cost:	Usually fixed rate tied to long-term market rates
Maturity:	Varying between 5 to 10 years and 25 years depending on use of proceeds
Collateral:	• Unsecured debentures for established, financially strong borrowers • Secured for asset acquisition purposes

Purpose:	To increase the return of investors' committed capital by averaging a small equity infusion with a large amount of debt
When a leveraged buyout is used:	To purchase an established business where there is a strong asset base and existing cash flow. The existing cash flow is used to retire the purchase money debt, and the strong asset base is used to further cushion the lender.
Participating debt sources:	• Commercial banks, particularly where there is an existing strong cash flow • Asset-based lenders, where cash flow may be weak but the asset (collateral) base is strong • Industrial revenue bonds, to finance with an attractive rate and maturity basis the purchase of machinery and equipment and real property

Sources of Equity Capital

(1) Small Business Innovation Research Grants (SBIR Grants)

Amount available:	Initially $50,000, with later commitment of up to $500,000, for each grant
Deal structure:	Contract or grant by agency or department of federal government
Cost:	Well-researched, documented proposal must be constructed and offered for review
Generally used for:	Seed capital or supplemental R&D capital
Advantages:	• Low cost, no equity give-up • Up to $550,000 available for each grant
Disadvantages:	Funds must be expended for specific project

(2) Professional Venture Capitalists

Amount available:	Usually $500,000 and above
Deal structure:	Varies across the board; in many instances, convertible preferred stock
Cost:	Long-term capital gain sought in area of three to ten times money invested over four- to seven-year investment horizon
Generally used for:	When business has extremely high growth potential ($50 million to $100 million sales in five years) and company plans to go public rather than remain private
Advantages:	Large amounts of risk capital available, much more than in case of wealthy individuals; investors bring contacts and business experience
Disadvantages:	• Equity give-up required • Company must follow planned high sales growth path expected by investors; company in most cases must become public, usually as soon as possible

Exempt Public Offerings

Certain offerings may be exempt from the registration requirements of the '33 Act. The three categories of exempt offerings are those for private placements of securities, unregistered public offerings, and intrastate offerings.

Private Placements of Securities

Exemptions for private placements of securities are available under Regulation D (Rules 504, 505, and 506) of the '33 Act.

Rule 504—Exemptions are available for the sale of up to $500,000 of securities, within any one-year period, provided that (1) the securities are not offered or sold through general solicitation or advertising and (2) their resale is restricted.

Rule 505—Exemptions are available for sales in excess of $500,000 and up to $5,000,000 of securities, in any one-year period, provided that the number of nonaccredited investors is limited to 35 persons. Accredited investors are defined generally to include institutional investors, select company insiders, and wealthy individuals. The restrictions concerning general solicitation or advertising, and resale, also apply.

Rule 506—Under this rule, unlimited amounts of securities may be sold, subject to the same restrictions concerning general solicitation or advertising and resale of the securities, provided that such sales are made to sophisticated investors.

Unregistered Public Offerings

Exemptions are available under Regulation A for offerings of up to $1,500,000 in a 12-month period. There are no restrictions as to the number or type of investors, no limitations on resale of the securities, and certain forms of general solicitation or advertising are allowed. However, unless the offering is under $100,000, an offering circular, which must be filed with and cleared by the SEC, must be provided to each purchaser.

Intrastate Offerings

The offering and sale of securities within a single state, by a company doing a substantial amount of business and incorporated within that state, may qualify for exemption from the registration requirements under the '33 Act, provided that the securities are only sold to residents of the state. Rule 147 provides a "safe harbor" by automatically granting the exemption to companies so incorporated and that also maintain their executive offices and have 80 percent of their assets within the state, derive 80 percent of their revenues from the state, use 80 percent of the offering proceeds in connection with business operations within the state, and indicate on the securities that resales to nonresidents are restricted to nine months after completion of the offering. There are no restrictions, however, as to general solicitation or advertising with regard to the offer or sale of the securities.

Green shoe: An option in a firm commitment underwriting agreement allowing the underwriters to purchase additional shares of stock from the issuer or the selling shareholders to cover overallotments.

Intrastate offering: Offering and sale of securities exempt from registration, sold only to residents of the state where issuer is doing significant business.

Investment banker: Individual who purchases securities from a company and/or the company's major shareholders and who sells those securities to the public. Also known as the underwriter.

IPO: Initial public offering.

Letter of intent: Preliminary, nonbinding agreement stating underwriter's intent to proceed with an offering.

Making a market: Efforts by a dealer to maintain trading activity in a particular stock by offering firm bid and asked prices in that stock on the public market.

Managing underwriter: Underwriter who leads the offering effort and who forms a syndicate of underwriters.

NASD: National Association of Securities Dealers, an association of brokers and dealers in the over-the-counter market. Reviews underwriters' compensations for fairness and reasonableness.

NASDAQ: National Association of Securities Dealers Automated Quotations. Computerized system containing information on all NASD-listed securities.

Over-the-counter market: Market made up of dealers who buy and sell securities not listed on an exchange. Typically between buyers and sellers over telephone lines.

Pricing amendment: Amendment to the registration statement stating the price of the offering.

Private placement: Offering of securities exempt from registration with the SEC.

Prospectus: Publication describing the company, management, and the nature of the business of a company making a public offering. Serves as the company's "selling" document.

Proxy solicitation: Form used to authorize an individual voting on another's behalf.

Red herring: Preliminary prospectus with a cover printed in red ink signaling that the registration statement has not become effective.

Registrar: Agency issuing certificates to new shareholders, checking transfers of stocks, and reconciling new stocks issued with number of stocks canceled.

Registration: Filing with the SEC to offer a company's securities for sale to the public.

Registration statement: Document submitted to the SEC containing the prospectus and financial information.

Regulation D: Provisions of the '33 Act containing rules that govern private placements.

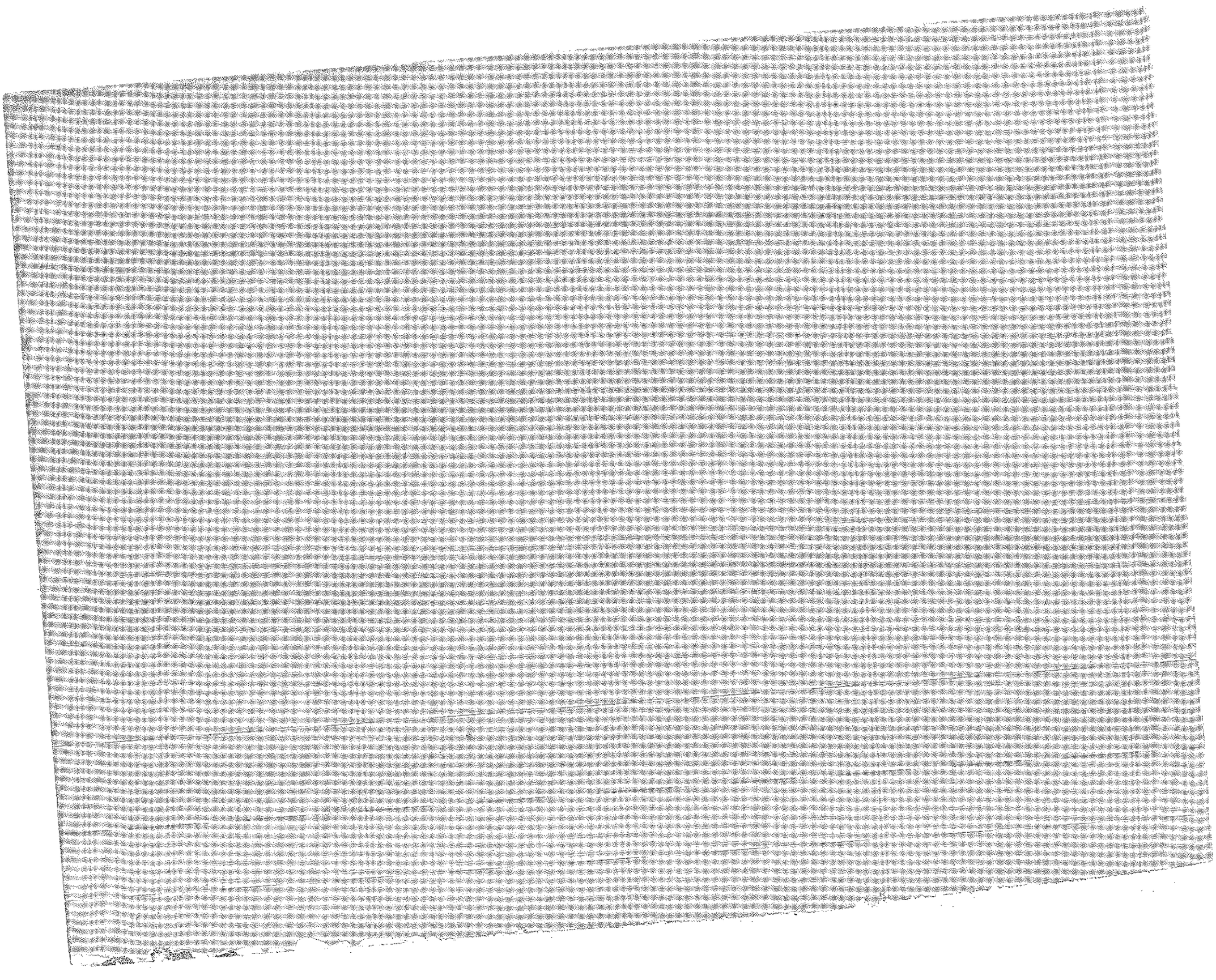
Regulation S-K: Instructions for preparing nonfinancial information for inclusion in the registration statement.

Regulation S-X: Instructions for preparing financial information for inclusion in the registration statement.

Road show: Presentations by CEO, management, and the underwriters on tour of the U.S. and/or foreign financial communities.

Rule 144: Exemption established in the '34 Act that allows, under certain conditions, the sale of restricted and control stock in the public market without registration of that stock.

SEC: Securities and Exchange Commission, a federal body administering federal securities laws.



Glossary

Aftermarket: State of the financial community's interest in the company after the public offering.

Agreement among underwriters: Agreement signed by the underwriting syndicate authorizing the managing underwriter to sign a purchase agreement with the company seeking an offering.

"All-hands" meeting: Planning meeting to prepare for drafting the registration statement, involving the CEO, the management team, the underwriters, the accountants, and the attorneys.

Bail-out: Offering in which management and/or shareholders sell their shares of the company's stock.

Best efforts: Underwriting agreement in which the underwriters agree to make best efforts to sell the company's securities but do not agree to purchase the unsold securities for their own accounts.

"Blue sky" fee: Registration fees paid in compliance with state laws governing the interstate sale of securities.

"Blue sky" laws: Individual state securities laws to protect investors against securities fraud.

Capitalization: Total amount of the stocks issued by a company. Includes all short- and long-term debt.

Closing: Meeting to exchange documents, certificates, checks, and receipts seven to ten days after the registration statement becomes effective.

Comfort letter: Accountant's letter to underwriters describing the results of procedures performed on the financial information included in the registration statement.

Deficiency letter: SEC letter describing deficiencies observed in its review of the registration statement.

Dilution: Reduction of one's relative interest, e.g., the sale of additional shares dilutes the percentage of one's ownership.

Director's questionnaires: Tool used by the company's attorneys and the underwriter's attorneys to gather information about the directors prior to registration. The questionnaires verify information to be disclosed in the registration statement.

Due diligence: Investigation performed by the underwriters, attorneys, and accountants to ascertain that information in the registration statement is accurate and complete.

Effective date: The day the registration statement is declared effective by the SEC. The underwriting agreement is then signed by the high technology company, the managing underwriter, and the selling shareholders.

Financial printer: Printer specializing in the printing of prospectuses and registration statements.

Firm commitment: Agreement by managing underwriter to purchase all of the stock being offered by the company and by the shareholders at an agreed-upon price. If the underwriter cannot sell all of the stock to the public, he or she will sell it at a later date.

Form 8-K: Form filed with the SEC noting change in the condition of the company.

Form S-1: Comprehensive, complex form used in application to the SEC for registration of securities in an initial public offering.

Form S-18: Simplified form used in application to the SEC for registration of securities.

Form 10-K: Form used to file annual report with the SEC, in compliance with the '34 Act.

Form 10-Q: Form used to file quarterly report with the SEC. Usually contains unaudited quarterly financial information.

(3) Small Business Investment Companies (SBICs)

Amount available:	Varies by SBIC, but usual range is from $100,000 to $1 million
Deal structure:	Varies from straight debt to straight equity; most common form of deal is hybrid security, either convertible debt or subordinated debt instrument with warrants to buy common stock attached
Cost:	Costs include both a rate of interest or dividend and equity participation in the business
Generally used for:	Expansion capital, working capital, acquisition financing, and leveraged buyouts
Advantages:	Provides subordinated capital, augmenting the equity base for borrowing purposes; by regulation, maturity on debt instruments must be at least five years; interest rates are usually fixed
Disadvantages:	Equity give-up required; investors may seek influence over business (e.g., board of directors' seat); usually must be fast-growth company with plans for going public within three to five years

(4) Minority Enterprise Small Business Investment Companies (MESBICs)

Amount available:	Varies by MESBIC, but usual range is from $100,000 to $1 million; MESBIC capital is available only to minority-owned businesses
Deal structure:	Similar to deals structured with SBICs
Cost:	Similar to costs of SBIC capital
Generally used for:	Startup capital, working capital, expansion capital, acquisition financing, and leveraged buyouts
Advantages:	Source of risk/equity capital for minority-owned businesses; provides subordinated capital augmenting the equity base for borrowing purposes; interest rates are usually fixed
Disadvantages:	By law, can only be used to fund minority-owned businesses; equity give-up required; investors may seek influence over business; usually must be fast-growth company with plans for going public within three to five years

Generally used for:	• Machinery and equipment • Real estate • Long-term working capital support needs
Advantages:	• Provide long-term capital • Market rates of interest
Disadvantages:	• Minimum loan amounts are usually high (e.g., $1 million or more) • Restrictive loan agreements usually required

(6) The Small Business Administration

Cost:	Can be floating or fixed, but subject to a government-imposed ceiling
Maturity:	Seven to 25 years, depending upon use of proceeds
Collateral:	Almost always secured by general floating liens on specific collateral; personal guarantees of owner required
Generally used for:	• When business is ineligible for conventional financing • Working capital • Machinery and equipment • Real estate
Advantages:	• "Lender of last resort" • Cost not commensurate with risk • Financing available for all types of assets
Disadvantages:	• All-inclusive liens usually required • Guarantees of major shareholders required • Financing available only to businesses that qualify

(7) Industrial Revenue Bonds

Cost:	Can be floating or fixed, but at "tax-exempt" rate, which is usually 70 percent to 85 percent of prevailing prime rate
Maturity:	Usually 5 to 15 years
Collateral:	Almost always secured by fixed assets
Generally used for:	• Machinery and equipment • Real estate • Rehabilitation of existing fixed assets • Limited working capital financing • Acquisition financing
Advantages:	• Low rate • Acceptable maturities • Usually funded by the company's commercial bank
Disadvantages:	• Can be hard to obtain, subject to market availability • Government can change rules • Higher closing costs, particularly higher legal fees

(8) Leveraged Buyouts (LBOs)

Definition:	The acquisition of a business or a group of assets using a high level of debt and little equity

Summary of Financing Approaches for High Technology Companies

In order to make a properly informed decision about whether going public is the best route to follow, a company will need to know other available sources for raising capital. Some of these sources, either in the form of nonpublic financings or public offerings exempt from SEC registration, are discussed in this appendix. These descriptions are general in nature and need to be further analyzed given the circumstances of each company.

Nonpublic Financing

Sources of Debt Capital

(1) Commercial Banks

Cost:	Almost always a floating rate based on the prime rate plus up to four additional percentage points
Maturity:	Varies across the board from demand (or 90-day notes) to committed lines of credit (1 to 3 years) to intermediate-term loans (3 to 5 years) and long-term mortgages
Collateral:	• Unsecured, general floating liens or specific liens on specific assets • Personal guarantees
Generally used for:	• Working capital needs • General expansion • Purchase of machinery and equipment
Advantages:	• Universal source • "Cradle-to-grave" relationships • Usually low-cost provider of capital
Disadvantages:	• Preference given to stable, established businesses • Startup companies are avoided • May require personal collateral or personal guarantees

(2) Commercial Finance Companies

Cost:	Almost always a floating rate based upon the prime rate plus up to six additional percentage points
Maturity:	One to eight years' (usually depending upon loan size—the larger the loan, the longer the commitment) revolving credit agreements; term loans of up to ten years
Collateral:	Always required; first liens on assets to be financed; personal guarantees usually required
Generally used for:	• Financing increased working capital needs • Acquisitions • The purchase of machinery, equipment, and real estate
Advantages:	• Aggressive lenders against balance sheet collateral • Will lend to troubled situations • Revolving credit arrangement allows availability to expand as asset base expands
Disadvantages:	• High rate lenders • If asset base contracts, borrower has to repay appropriate part of advance quickly • Structured initially as demand obligations, will usually move quickly to liquidate if trouble occurs

CEO: What are the requirements for listing on the stock exchanges of Singapore?

KPMG, Singapore: Entry requirements for the junior securities market are not yet established, but they will most likely be considerably less stringent than those of the Singapore Stock Exchange.

Companies incorporated in Singapore and applying to the stock exchange for a full listing are expected to meet the following criteria:

- Track record of earnings for the past three to five years
- Paid-up capital of at least $2 million
- Assurance that at least $750,000 or 25 percent of the paid-up capital is in the hands of no fewer than 500 shareholders
- Assurance that 10 percent to 20 percent of paid-up capital is in the hands of small investors

Foreign companies are expected to meet the following criteria:

- Quotation must be listed on a stock exchange or traded in an over-the-counter market in the country of incorporation
- Must have net assets of at least $23 million
- Must have pretax income of $23 million—cumulative for the latest three years—or $9 million for any one of three years

CEO: What professional advisers are involved in going public, and what are their roles?

KPMG, Singapore: In Singapore, the company will likely seek advice from a merchant banker, accountants, tax advisers, solicitors, and possibly other advisers.

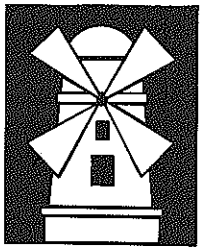
The merchant banker coordinates entering the market, advising on the feasibility of the public offering, drafting the documents, and pricing the shares. The accountants act as business advisers on the feasibility of the public offering and restructuring that may be necessary prior to the public offering, issuance of reports on financial performance and position, and forecasts of profits. The tax advisers, usually the accountants, advise on the tax implications of going public. Solicitors advise on the wording in documents issued to market the company shares, on complying with legal requirements, and on reviewing underwriting and restructuring agreements.

Other advisers, such as real estate appraisers, plant and machinery appraisers, and industry specialists, become involved in issuing documents as is necessary.

CEO: If my emerging company seeks to enter the Singapore public market, how must I proceed?

KPMG, Singapore: Upon deciding to seek a listing, a company should contact an accountant or a merchant banker about the feasibility of listing. Then, if the decision is to proceed, a company should apply to the stock exchange and issue a prospectus. In writing the prospectus, a company should ask for assistance from an accountant and a merchant banker. The prospectus should include:

- A description of the company's history, nature of the business, qualifications of management, and prospects for the future
- Financial information, including results for the past five years, balance sheets for the past six years, and net asset backing
- The accountant's and advisers' reports



CEO: What are some of the requirements for listing on the parallel market?

KPMG, Amsterdam: The company must present the following documents in applying for an official listing on the parallel market: a copy of the prospectus with signatures of the subscribers, a declaration stating that the prospectus has been sent to members of the Amsterdam Stock Exchange, a statement from the auditor certifying permission for the auditor's opinion to be included in the prospectus, and a declaration stating the number of shares placed on the exchange.

CEO: Is a prospectus in The Netherlands comparable to a prospectus in the United States?

KPMG, Amsterdam: Yes, but it is simpler. A prospectus for the parallel market must include the following types of information:

- Name and address of the company, and the names of the managing director and supervisory directors
- Names of shareholders and numbers of shares held, as well as names of individuals with rights to shares
- Date of establishment and approval of articles of association
- Information about the company's registration with the chamber of commerce
- Capital
- Final and certified annual report
- Financial information relative to the company's financial situation and state of business
- Declaration of the location of the most recent annual report and articles of association
- Accounts and distribution of profits for the last three years

CEO: Is the prospectus circulated to potential investors as it is in the United States?

KPMG, Amsterdam: No. It is possible to publish the most important figures in the daily newspapers as well as in the "Official Price List." Unlike the rule in the United States, the prospectus does not have to be circulated; the company need only declare that the prospectus is available at the company.

CEO: What are the ongoing requirements of listing on the parallel market?

KPMG, Amsterdam: The company must publish a report containing financial results for the first half of the year by the end of the third quarter. After the directors have reviewed the results of the previous year, they are expected to publish a report of the year's highlights. Any interim data that may have a significant effect on the price of shares are required to be issued to the Commissioners for the Quotation, and immediately thereafter to the public.

The Hong Kong Stock Exchanges



CEO: My company is looking for future markets in China. Should I consider the Hong Kong stock exchanges as possible sources of equity capital?

KPMG, Hong Kong: Hong Kong is a major financial center, with an active stock market. Hong Kong is in close proximity to China and is not subject to any form of exchange control. Recently, the four exchanges in Hong Kong have been unified as one. Notwithstanding the existence of a securities commission, the market is largely self-regulated, without the equivalents of U.S. Forms 10-K and 10-Q.

The West German Exchanges



CEO: How do the West German exchanges compare with the U.S. exchanges?

KPMG, Frankfurt: The New York Stock Exchange lists only 50 foreign stocks. Of the 420 companies listed on the Frankfurt Stock Exchange, dominant among Germany's 8 exchanges, 180 are foreign companies.

CEO: What benefits do the West German exchanges offer the U.S. company?

KPMG, Frankfurt: If a U.S. company is looking for new financial resources, visibility, and a diverse stockholder structure, then the West German exchanges may be attractive vehicles. The public market in Germany has strong international ties, up-to-date information about foreign companies, and a streamlined system for trading.

CEO: How is the German stock market structured?

KPMG, Frankfurt: The German public market has three tiers—the official market, Amtlicher Borsenhandel; the regulated unofficial market, Geregelter Freiverkehr; and unregulated unofficial trading, Ungeregelter Freiverkehr.

In the first tier, or the official market, "official brokers" match, buy, and sell orders and determine the official price. Only listed securities that have met the requirements of German stock exchange law and individual exchanges can be traded in this market.

In the second tier, or the regulated unofficial market, application for admission may be the first step in introducing shares to the public. Dealings in these securities take place during trading hours between unofficial brokers and banks, with no official quotation. The admission procedure is similar to the official market, but there are fewer requirements.

In the third tier, or unregulated unofficial trading, also known as "telephone trading," trading takes place before and after traditional trading hours and is not subject to special regulations. For a foreign company wishing to establish its name in the financial community before entering the public market, unregulated unofficial trading may be the first step toward admission to the regulated unofficial or official markets.

CEO: Who are the key players with the West German stock exchanges, and what are their roles?

KPMG, Frankfurt: The principal people and organizations advising and assisting the CEO and his or her company are the underwriting syndicate, the accountant, the tax consultants, and the notaries and attorneys.

New issues of stocks are handled by the underwriter or banker. The underwriter determines whether the company is fit to be brought to market, and then engages an accountant to examine the financial statements and value the company. The banks handle both the new issue business and the securities deposits, arrange the timing of the issue, offer advice about the documents, assist in pricing the shares, and handle the formal steps of listing with the exchange.

KPMG, Paris: Entry to the Paris public stock markets increases the visibility of the growing high technology company in France. And the costs are less than the costs in a number of other foreign stock exchanges. As in other foreign exchanges, marketability depends on these factors:

- Strong position in the technology sector
- Profit record—particularly a rising trend
- Future prospects—good anticipated growth

CEO: What are the eligibility requirements for companies seeking a listing on the Paris stock exchanges?

KPMG, Paris: Eligibility for the official market is granted if the high technology company has its stock already listed on a stock exchange of a country other than France.

Eligibility for the second market is usually granted if the high technology company has been trading on the Paris over-the-counter market for at least three years and can produce audited financial statements.

Foreign companies must provide audited financial statements for the listing application. These statements need not be audited by French auditors; however, they must be translated into French and reviewed by French auditors.

In addition, a listing on the Paris stock exchanges must not be a mere nominal registration. The Stock Exchange Commission expects sufficient dealings in the stocks in Paris. The rule may require placing shares with French investors or with the sponsoring bank, if the investors do not hold sufficient stock to ensure marketability of the securities.

CEO: How does a U.S. company make an application for a listing on the Paris stock exchanges? How long does it take?

KPMG, Paris: A company must spend about six months meeting procedural requirements for listing with the Paris stock exchanges—requirements of the Commission des Opérations de Bourse (COB), the Ministry of Economy, and the Stockbrokers' Association (CSAC).

To begin, the company files with the appropriate authorities. Once the authorities have assessed the company and have determined its interest to French investors, a sponsoring bank takes over the responsibility for the overall planning of the listing. The sponsoring bank's responsibilities include preparing applications for the Ministry of Economy, the COB, and the CSAC; working with the officers and auditors in reviewing the financial statements; and maintaining a market in the newly listed stock.

CEO: What are the steps in the application process?

KPMG, Paris: In Paris, the application process consists of two stages.

The preliminary application is made both to the Ministry of Economy and the COB. The application includes a letter, the current annual report, and a description of the

- Description of the business
- Risk factors
- Recent acquisitions/dispositions of assets
- Variations in operating results
- Executive compensation
- Promoters of the company
- Legal proceedings
- Dividend record
- Directors and officers
- Options to purchase securities
- Escrowed securities
- Principal holders of securities
- Intercorporate relationships
- Interest of management and others in material transactions
- Material contracts

CEO: What are the requirements for sharing the risks and rewards?

KPMG, Toronto: Two policies have been established to balance the sharing of risks and rewards between the promoter/founder and the public investors. The first, the Founders Stock Policy, requires that "cheap stock" issued to the founders before the initial public distribution be held in escrow. In some instances, the policy may be enforced to "lock in" key executives who are critically involved in the management of the company. The shares in escrow are later released on the basis of automatic and performance-related release provisions.

The second, the Promoter's Option, reserves up to 20 percent of the Treasury securities offered under an exchange offering prospectus (EOP) for the promoter/founder. Under this option, the exercise price must not be less than the price offered to the public under the EOP; the term for the option is limited to two years, and the option cannot be exercised within the first year.

CEO: What are the costs of an IPO?

KPMG, Toronto: Costs vary from one issue to another depending on the size of the offering, just as they do in the United States.

CEO: Who is legally responsible for the information in the prospectus?

KPMG, Toronto: The Ontario Securities Act contains provisions holding the company, the underwriters, the directors, and "experts" liable for misrepresentations contained in the prospectus. The act also provides specific defenses. A "reasonable investigation," for example, supports the belief that the prospectus contains no misrepresentations.

CEO: What is a "reporting issuer," and what are its requirements?

KPMG, Toronto: A reporting issuer is a company in which shares are listed on the TSE. The reporting issuer is required by Ontario's Securities Act to provide continuous and timely disclosure through the following documents:

- Quarterly financial statements to be filed within 60 days of the quarter-end
- Press releases to be issued promptly upon a material change in the business of the company

The accountants will assist by auditing the company's financial statements, reviewing the business plan, advising on accounting issues and policies, providing a comfort letter to the underwriters and/or board of directors, and responding to comments on the financial statements made by the securities commission's staff.

The underwriters determine the plan of distribution and serve in making and maintaining the market.

CEO: What are the costs of an IPO on the Vancouver market?

KPMG, Vancouver: The cost of a $750,000 underwriting ranges between $20,000 and $37,000, depending upon the level of assistance provided by the founding shareholders. That estimate includes the technical report, legal and accounting fees, and printing and filing fees. Brokers' commission rates are regulated. For issues less than $3 per share, commissions can be no more than 15 percent of the proceeds from the initial distribution; for issues greater than $3 per share, commissions can be no more than 10 percent of the proceeds from the initial distribution. Additionally, rules and regulations apply to brokers who agree to a "guaranteed agency agreement," a "firm underwriting," and associated underwriting options.

CEO: What about ongoing disclosures?

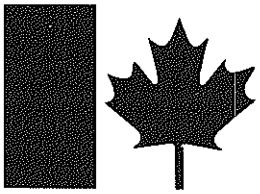
KPMG, Vancouver: In its enforcement of after-listing requirements, the VSE operates on a philosophy of full, plain, true, and timely disclosure of material information. The company will need to pay close attention to its own promotion and to maintaining an effective relationship with its market makers.

In addition, as imposed by the British Columbia Securities Act, which took effect February 1, 1987, companies are also required to file quarterly reports and prepare interim (quarterly and six-month) reports.

CEO: How would you characterize a potentially successful offering on the VSE?

KPMG, Vancouver: A potentially successful offering on the VSE can be characterized as one in which the company and the management team have a proven track record; exceptional corporate performance, particularly if the company is in a rapidly growing industry with products, processes, or services on the leading edge; technological innovations; and opportunities in rapidly expanding markets.

The Toronto Stock Exchange



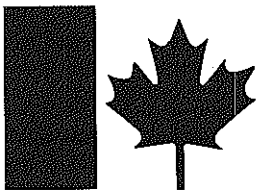
CEO: Why should I consider taking my company public on the Toronto Stock Exchange?

KPMG, Toronto: Established over 125 years ago, the Toronto Stock Exchange (TSE) is recognized as a world-class exchange. As Canada's largest stock exchange, it traditionally handles over 70 percent of the dollar volume of all stocks traded on Canadian exchanges. To encourage the development and growth of emerging companies, the TSE, in cooperation with the Ontario Securities Commission (OSC), permits IPOs. Recently, the TSE also established a high technology index to raise the profile of the high technology companies on the exchange.

For purposes of listing on the TSE, applications from U.S. companies are treated as applications from Canadian companies.

CEO who is considering entering the London markets should seek advice from a stockbroker as early as possible.

The Vancouver Stock Exchange



CEO: Is it true that the Vancouver Stock Exchange is a promising source of financing and liquidity for high technology companies inside and outside of Canada?

KPMG, Vancouver: Yes. The Vancouver Stock Exchange (VSE), in British Columbia, Canada, is widely recognized as a leading venture and risk capital exchange in North America. The VSE, in an effort to remain the leading junior seed capital market in North America and to recognize the unique characteristics of young, emerging high technology companies, has recently implemented policy changes. These changes are intended to assist young high technology companies in their efforts to go public. The listing procedures have been streamlined to speed up the going public process and to reduce the completion time and cost. The result is an efficient process for going public in which time and cost restraints of young, rapidly growing high technology companies have been taken into consideration.

CEO: The VSE is well known for its role in helping natural resource and development companies raise equity. Can the VSE play an equally strong role in helping emerging high technology companies?

KPMG, Vancouver: Yes. There are strong parallels between resource companies and high technology companies in their formative stages. They have similar needs in terms of equity requirements, management team building, investor types, and risk/return relationships. The VSE is, therefore, an exchange experienced in providing high-risk capital for companies seeking to raise capital for the maturing industries of the 1990s.

CEO: How does the Vancouver exchange really work?

KPMG, Vancouver: In order to take the company public, the CEO must attract the sponsorship of a Canadian securities dealer. Because securities dealers receive many proposals from emerging high technology companies, they screen each proposal to decide whether investing in the company meets the investment objectives of their clients. Their decisions are based on the company's corporate profile—the management team, the potential value of stock, an innovative product, an innovative technology, and the market. The securities dealers will also base their decisions on the quality of the business plan and the strength of its outside professional advisers.

CEO: Who administers the securities regulations?

KPMG, Vancouver: The regulatory environment in British Columbia is defined by the Securities Act, which is administered by the Superintendent of Brokers. The Superintendent of Brokers' Office is the equivalent of the SEC and has power and responsibility to require compliance.

CEO: What is the size of a typical initial public offering (IPO) on the VSE?

KPMG, Vancouver: Typically, the offerings range from U.S. $375,000 to $1,500,000

The accountant acts as a general business adviser and is significantly involved in initial public offerings. The accountant's report on financial results is required upon entry to the markets. Also, the accountant reports on profit forecasts made in the issue documents and reviews the adequacy of working capital. Usually, the sponsor will request from the accountant a "long-form report," providing information on the business and the financial position of the company.

The accountant also fills the role of tax adviser, addressing the tax implications of going public from the perspective of the company and its shareholders.

The U.K. solicitor is responsible for verifications of statements made in the prospectus. The solicitor also advises on the wording of documents and on compliance with legal requirements, much in the same manner as the U.S. SEC counsel.

Going public on the London markets may also involve such other advisers as real estate appraisers, industry specialists, and public relations consultants.

CEO: How do entry procedures and costs associated with the London markets differ from those in the U.S. market?

KPMG, London: In short, the procedures are less detailed, and the costs are lower.

In the United Kingdom, both the law and the investors require a published prospectus. The three-part document describes the business, products, management team, and prospects in part one; the financial results for five years in part two; and statutory and legal information in part three. A company listing on the USM reports financial results for three years in part two. The prospectus is similar to the prospectus published in the United States, but it is much less detailed.

If the emerging high technology company is required to submit a "long-form report," the accountant will prepare it. The long-form report is not a public document, but rather is furnished to the sponsor. It takes about five weeks to complete and, depending on the nature of the business, describes the company in the following terms:

- History and development of the business
- Group structure and legal framework
- Directors, management, and employees
- Trading policies and strategies
- Management information and accounting systems
- Accounting policies
- Trading results and future prospects
- Net assets
- Taxation
- Pensions

Costs for entering the London markets depend on the method of issue, the nature of the business, the amount of money sought, the extent to which the issue is advertised, and the market entered. For example, raising $5 million on the USM might cost between $200,000 and $300,000 for a private placement and between $300,000 and $500,000 for an offering to the public, while raising $40 million on a listed securities market could cost about $1.4 million.

Perspective: The CEO

Peat Marwick tells me that I should also look at the possibilities for listing my company's securities on a foreign exchange. The notion seems strange, yet intriguing. The United States has its own highly developed securities market—so why go thousands of miles away from home to raise equity capital? On the other hand, as Peat Marwick points out, the environment in which high technology companies operate is truly a global one. Plus, the availability of equity capital markets for high technology companies is beginning to increase around the world. I view the business environment as global; I view the markets for the products as global—perhaps I should also view business financing as global. What are the international opportunities? Who are the investors? What influences them? And what is the regulatory framework of foreign public markets?

The Foreign Exchanges



Investor interest on foreign exchanges is strong for young U.S. high technology companies

For an overview of what is involved in going public on foreign exchanges and of the pros and cons of foreign financing alternatives, Peat Marwick's high technology practice looks beyond the domestic scene to the securities markets of London, Vancouver, Toronto, Paris, Frankfurt, Amsterdam, Hong Kong, and Singapore.

Securities exchanges outside the United States are not explored as actively as they warrant, particularly by younger, growing high technology companies. Investor interest is strong, and the listing and reporting requirements are often more feasible than in the United States. In addition, due to lesser issuance costs, oftentimes more equity capital in absolute dollars can be raised on foreign exchanges.

A U.S. high technology company may go public for the first time on a foreign exchange, or it may list its securities there as a method of raising supplemental equity capital after going public in the United States.

In addition to the obvious benefit of raising more equity capital in absolute dollars, listing on foreign exchanges may have other advantages over listing on U.S. exchanges, such as:

- Diversifying equity ownership of the company
- Providing a broader market for the company's securities
- Enhancing the company's recognition in its overseas marketplaces
- Less complex reporting requirements with less regulations (however, if a U.S. company has assets exceeding $5 million and a class of equity securities held by 500 or more shareholders, the company must comply with the periodic reporting requirements of the U.S. Securities Exchange Act of 1934 regardless of the residence of these shares)

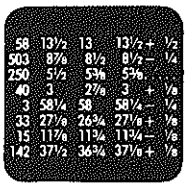
Possible disadvantages may also arise when taking a company public on a foreign stock exchange, such as:

- The foreign markets might lack a certain degree of the image and prestige associated with the U.S. markets. This can possibly dilute the attractiveness to executives who are given stock-based compensation benefits.
- Shares on foreign markets may not be as attractive for corporate acquisitions as those registered on the U.S. markets.

Interviews with KPMG's High Technology Professionals in . . .

Peat Marwick's high technology professionals in the United States work with their associates in offices around the world to assist CEOs of U.S. high technology companies in weighing the advantages and disadvantages of this unique and exciting opportunity to raise equity capital on foreign exchanges.

Insider Reporting and "Short Swing" Profits



58	13½	13	13½	+ ½
503	8⅞	8½	8½	– ¼
250	5½	5⅜	5⅜	
40	3	2⅞	3	+ ⅛
3	58¼	58	58¼	– ¼
33	27⅛	26¾	27⅛	+ ⅛
15	11⅞	11¾	11¾	– ⅛
142	37½	36¾	37⅛	+ ⅛

The '34 Act requires each officer, director, and holder of more than 10 percent of any class of equity security to file a report, Form 3, with the SEC shortly after the initial public offering becomes effective. This report discloses all beneficial holdings of all equity securities of the company. Once Form 3 is filed, any change in the reporting person's beneficial holdings occurring during any calendar month must be reported on Form 4 within ten days after the end of such month.

Persons required to file both Form 3 and Form 4 are subject to the "short swing" profits provision of the '34 Act. The provision stipulates that if a reporting person realizes any profits on the purchase and sale or sale and purchase of the company's equity securities within a six-month period, the person must turn the profits over to the company without offset for losses. This provision applies regardless of whether the reporting person's trading was based on material inside information or whether the person's trading losses exceeded his or her trading profits. If the company does not sue to recover those profits, any shareholder may do so on behalf of the company.

The '34 Act prohibits reporting persons from making "short sales," a term applied to selling shares they do not own, or "sales against the box," a term applied to selling shares they do own but do not deliver within 20 days after the sale.

"Insiders" must disclose to the investing public any material nonpublic information before engaging in stock sales or purchases

The antifraud provisions of the '34 Act require that insiders of the company must disclose material nonpublic information before participating in securities transactions. An officer, director, or controlling shareholder is considered an insider. An insider who is in possession of material nonpublic information concerning the company must either disclose this information to the investing public or abstain from trading in or recommending the securities of the company while this inside information remains undisclosed.

"Tipping"—insiders passing undisclosed information to an outsider to exploit information for their personal gain—is viewed as a means of indirectly violating the "disclose or abstain from trading" rule, which applies to all insiders. The person who receives the information from the insider is known as the tippee. The tippee has an obligation not to trade on this information if the tippee is aware that the insiders have breached their fiduciary duty to the shareholders.

The Insider Trading Sanction Act of 1984 gave the SEC the authority to seek a civil penalty up to three times the amount of profits gained or losses avoided by a person who knowingly trades on material nonpublic information.

Rule 144: Resale of Restricted Securities

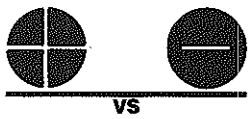


Restricted securities are those that have been acquired directly or indirectly from an issuer in a transaction that did not involve a public offering or those that have been acquired through the resale limitations of Regulation D. Restricted securities generally may not be resold in the public marketplace unless they are registered under the '33 Act or sold in compliance with Rule 144.

For the CEO, restricted securities become an important issue when the CEO and his or her employees own a large block of stock. Their ability to sell the stock will be related to the issues of time and volume.

In order to sell securities under Rule 144, they must be registered under the '34 Act for at least 90 days, and all of the requisite periodic reports must be filed. The rule permits

Perspective: The CEO



Now that I have gone public—how public is public? What is the commitment? The management team and I are obliged to keep the officers, the board of directors, the shareholders, and committees apprised of all current developments affecting this growing and changing high technology company. Making decisions will become more complicated, won't it? With each major decision, we need to consider if approvals by the board of directors or the shareholders are necessary, if a timely press release is appropriate, or if a current report should be filed with the SEC. We also need to ask if the decision will affect the financial results and, in turn, the stock price. We can no longer make decisions in a vacuum, can we?

The Value of the Stock

The CEO of the public high technology company will quickly learn that the new shareholders' primary concern is the value of their stock. Management will be under pressure to maintain and then increase the market value of the stock. This increase is normally accomplished by consistently improving quarterly profits. Management's ongoing challenge will be to balance the pressures of short-term earnings impacts with the long-term development of the company.

The CEO works constantly to maintain a positive image for the company among the investment community

The promotion of the company does not stop after the offering. The CEO must continue to take advantage of all opportunities to tell the story of the company. The more widely the company is known, the better is the opportunity for a broader market for its shares. Part of the responsibility of being public is making every effort to seek out groups of research analysts and investment advisers to promote the company. A positive image with the investment community is crucial to the development of a public high technology company.

The Use of Proceeds

One of the new concerns for the CEO of the public company is the use of proceeds. *The company is required to use the proceeds substantially as described in the prospectus.* If the proceeds are used otherwise, the SEC may take action against the company for having filed a registration statement that included an untrue statement of a material fact. If the registration statement is the first filing under the '33 Act, the company will need to file with the SEC a Form S–R, which is a report on the use of proceeds. Initially, Form S–R is filed approximately three months after the registration statement goes into effect, and once every six months thereafter. A final form is filed within ten days after the proceeds have been fully applied.

Periodic Reporting

The company is required to file periodic reports beginning with the first fiscal year in which the registration statement is declared effective. The only exception to ongoing reporting requirements is that after the first year the obligation to file periodic reports can be suspended under certain circumstances: If the number of shareholders falls below 300, or if after the first two fiscal years subsequent to going effective there are less than 500 shareholders, and the company reports less than $5 million in assets on the last day of each of the previous three years, then the company's obligation to file periodic reports will be suspended. However, those securities listed on national securities exchanges or traded over the counter with transactions reported on the National Association of Securities Dealers Automated Quotations (NASDAQ) will register under Section 12 of the '34 Act and will be subject to the periodic reporting rules regardless of the number of shareholders and the amount of assets.

To comply with the '34 Act, the SEC requires that the company file routine periodic reports, including:

In Summary . . .

Perspective: The CEO

Planning: The "All-Hands" Meeting

Deciding on the Appropriate Method of Application to the SEC:
- Form S–1
- Form S–18
- Regulation S–X
- Regulation S–K

Drafting the Registration Statement:
- Part I, The Prospectus
- Part II, Supplemental Disclosures
- Due diligence

Filing with the SEC

SEC Review

Amendments

Pricing

Filing Under "Blue Sky" Laws and with NASD

Waiting and Preliminary Marketing

The Road Show

Due Diligence

Going Effective

Closing

Developing the Timetable:
- Dates
- Activities
- Responsibilities

Tentative Date	Activity	Responsibility
	Arrange for and notify registrar, transfer agent, and financial printer.	ATC
	Arrange for preparation of stock certificates by banknote company.	ATC
	Distribute officers', directors', and selling shareholders' questionnaires. Establish custodian arrangements and powers of attorney for selling shareholders.	CC
June 28	Distribute second draft of S–1 and draft underwriting documents to registration team.	UC/CC
July 1–2	Drafting session. Continue due diligence.	All
July 5	Distribute first printed proof of S–1 including all financial statements to registration team.	UC/CC
Week of July 6	Drafting session.	All
	Review market conditions, timing, filing date.	U
	Send revised S–1 and underwriting documents to printer.	UC/CC
	Continue due diligence activities; discuss comfort letter with accountants.	U/UC
July 7–8	ATC officers, directors, and selling shareholders return completed questionnaires.	ATC/SS
	ATC board meeting to approve issue, establish pricing procedure, approve Form S–1 and underwriting agreement.	ATC
	Officers, directors, and selling shareholders sign S–1 execution pages.	ATC/SS
	Review proposed syndicate list.	U
July 11	Distribute second printed proof of S–1 to registration team.	CC
July 14	Final working session at printer to review new proof; make final changes in S–1 and other documents.	All
	Accountants sign report and consent included in S–1.	A
July 15	File S–1 with SEC and NASD.	CC
	Press release issued.	ATC/U
Week of July 20	Syndicate invitations sent.	U
	Begin "blue sky" qualification.	UC
	Arrange securities market listing.	CC



The road show usually includes the following:

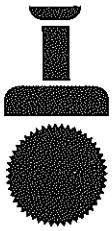
- Meetings with the managing underwriter's account executives. These meetings are conducted in person. In some cases, a videotape will be prepared for distribution to retail offices that are not visited.
- Meetings with account executives of the syndicate.
- Group meetings with institutional investors.
- One-on-one meetings with institutional investors.
- Meetings with analysts.

The meetings give the audience the opportunity to raise questions about the company and to clarify any information in the preliminary prospectus. The managing underwriter will accompany the CEO at all of the meetings and will help him or her prepare for the types of questions expected and how to respond to them. The road show typically requires a week for preparation and one to two weeks to complete.

Due Diligence

At the close of the road show, representatives of management, the accountants, the company's SEC counsel, the underwriter's counsel, and the underwriter will meet to exchange final information about questions and problems related to the offering.

Going Effective



The binding underwriting agreement is not normally signed until within 24 hours of the expected effective date of the registration statement—often on the morning of the date of effectiveness. Thus, throughout the process of preparing the registration statement and during the waiting period, the company will have incurred substantial expenses without assurance that the offering will take place.

It is possible that the underwriters could decline to complete the offering if the market drops sharply during the waiting period, especially if the offering is small or highly speculative or there are significant adverse developments in the affairs of the emerging high technology company or its industry sector. More commonly, however, the offering may be completed at a lower offering price and/or with fewer shares being offered. On the other hand, a sharply improved market could result in a higher offering price and perhaps more shares being offered.

The day before the effective date, the managing underwriter and the company agree on the final offering price to the public. On the morning of the date the registration statement is declared effective, the underwriting agreement is signed by the company, the managing underwriters, and the selling shareholders. The underwriting agreement will include the offering price of the stock, commissions, discounts, and expense allowances.

Closing



The closing is a meeting attended by all parties involved in the offering. It usually takes place seven to ten days after the registration statement becomes effective. This period allows the underwriters time to collect the funds from their customers. The purpose of the meeting is to exchange documents, certificates, checks, and receipts. During these exchanges, the underwriters give the company a check for the proceeds from the offering, net of the underwriting compensation. In addition, the registrar and transfer agent give the underwriters the stock certificates.

After the staff has reviewed the registration statement, the SEC will respond in writing to the company or to its SEC counsel regarding any deficiencies or questions. Most initial public offerings receive comments.

Amendments

Disclosing more, rather than less, information in the initial filing may prevent a recirculation of the document

Depending upon the nature and extent of the comments in the "deficiency letter" from the SEC, the SEC counsel, the underwriter's counsel, and the accountants will advise the CEO how the company should respond. If the company is required to make significant changes, an amended registration statement must be filed with the SEC. In certain situations, the amendment may require the reprinting and redistribution of the preliminary prospectus to the underwriting syndicate, as well as to potential investors who have received copies of the preliminary prospectus. This process is referred to as a full recirculation. The recirculation process is costly, and it may adversely affect the marketing of the offering. Therefore, the CEO and management should strive for completeness and accuracy in the initial filing with the SEC.



If the changes resulting from the SEC's comments are not significant, the company will not have to recirculate the preliminary prospectus. The company can respond to insignificant changes by sending the SEC a copy of the printer's proof of the registration statement with all of the recommended changes, or by a letter advising the SEC how the company intends to respond to the insignificant changes, indicating that these changes will be included in the pricing amendment.

Deficiencies frequently noted by the SEC include:

- Management's background and experience are misstated or not fully disclosed. For example, prior legal problems of management and prior business failures in other companies should be disclosed.
- The current status of the business and its products, including problems of or uncertainties about a new or existing product, are not fully disclosed.
- Related-party transactions are not properly disclosed.
- Management's discussion and analysis is lacking substance in its description of the operations.
- Detailed financial statement disclosures are missing or need to be expanded.

Pricing

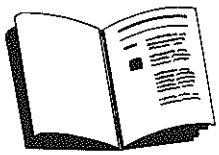
Once the amendments containing all of the corrections are filed, the final amendment with the final offering price information can be included in the registration statement. Once the SEC is satisfied that all the necessary disclosures have been made and the company, the SEC counsel, and accountants have determined that the registration statement does not have to be updated for developments subsequent to the filing date, the pricing amendment is filed.

The actual offering price is not finalized until the offering becomes effective

The '33 Act provides that final registration statements automatically become effective 20 days after they are filed with the SEC. However, the SEC does have the right to accelerate the effective date. The price for the securities will be fixed based on market conditions at the close of business on the day the pricing amendment is finalized. Since market conditions are subject to change, the underwriters will not want to wait the 20 days after determining the offering price before they can begin to sell the securities. Therefore, most companies attempt to have the effective date accelerated to the date the pricing amendment is filed. As soon as the company is satisfied that the SEC has granted the request for acceleration, the printer will begin printing the final prospectus.

— The extent of both their security holdings and the holdings of principal shareholders with more than 5 percent of any class of shares
— Family relationships and the nature of certain related-party transactions between them and the company
— Loans to related parties or to their immediate families

If the company has existed for less than five years, certain transactions with its promoters must also be disclosed.



► *Description of securities to be registered.* The description should address such matters as dividend rights, conversion or redemption provisions, voting rights, liquidation and preemption rights, and any restrictions that apply to the securities.

► *Plan of distribution.* The distribution plan will typically disclose the names of the principal underwriters, the amount of each underwriter's purchase, the underwriting method of either a firm commitment or a best-efforts basis, and any material relationships, compensation, or indemnification arrangements that exist between the underwriters and the company.

► *Other.* Other information will include legal opinions, the identification of experts who assisted in the preparation of the registration statement, and reference to the availability of other information filed with the SEC in Part II of the document.

Financial statements and schedules are prepared in accordance with Regulation S–X

► *Financial information.* The following financial statements and schedules within the prospectus will be prepared in accordance with Regulation S–X:
— Audited balance sheets as of the end of each of the two most recent fiscal years
— Audited statements of income, changes in stockholders' equity, and changes in financial position for each of the three fiscal years preceding the date of the most recent audited balance sheet
— Unaudited interim financial statements, on a comparative basis with the preceding fiscal year, if the effective date of the registration statement is not expected to be within 134 days of the most recent fiscal year

The registration statement may require audited financial information related both to unconsolidated subsidiaries and to businesses that the company has acquired.

Part II, Supplemental Disclosures

This section of the registration statement will contain information that is available for public inspection, but that is not required to be included in the prospectus. That information will include:

► Other expenses of issuance and distribution
► Indemnification of directors and officers
► Sales of unregistered securities within the past three years
► A listing of the exhibits filed with the registration statement, such as an underwriting agreement, a corporate charter and bylaws, leases, material contracts, and financial schedules prepared in accordance with Regulation S–X

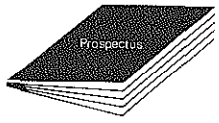
The prospectus serves as both a selling document and an explanation of any negative factors or uncertainties about the company

The registration statement consists of two parts: Part I, The Prospectus, and Part II, Supplemental Disclosures. The Prospectus is the offering document that is distributed to the potential purchasers of the securities. Part II is filed only with the SEC for public inspection.

The prospectus has dual and somewhat conflicting purposes. As stated, the prospectus is an offering document used by a company to sell stock to the public. As such, an emerging high technology company might be inclined to highlight all of its positive aspects. The company, however, must disclose the appropriate negative factors and uncertainties as well, to protect itself against lawsuits for misstatements or omissions of potentially damaging information. In order to reduce the risk of liability, the SEC counsel and the underwriter's counsel will insist that the registration statement be written in a conservative manner.

Part I, The Prospectus

The company electing to submit its application for registration to the SEC using Form S–1, in accordance with Regulation S–K, would develop a prospectus containing the following sections:



- *Outside front cover.* This page highlights key features of the offering, including the name of the company, title, amount, and a brief description of the securities; a table showing the price to the public, underwriting discounts and commissions, and proceeds to the issuer; and date of the prospectus.

- *Inside front cover and outside back cover.* A table of contents and information concerning price stabilization and distribution of prospectuses are provided on these pages.

- *Prospectus summary.* This section, normally on the first page after the inside front cover, briefly summarizes the company, the offering, and financial information about the company.

- *The company.* This section provides a brief background statement about the organization and location of the high technology company, and a description of its business.

- *Risk factors.* A discussion of such risk factors as the absence of an operating history, the nature of the business, and the financial position should be provided for a high-risk or speculative offering.

- *Use of proceeds.* The company must state the principal uses of the net proceeds of the offering and the approximate amount intended to be devoted to each purpose.

- *Dividend policy.* The company should disclose its dividend payment history and whether it intends to pay dividends in the future.

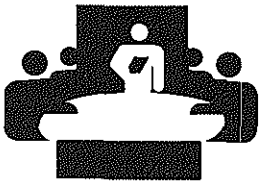
- *Dilution.* When there is a significant disparity between the price paid by the existing shareholders and the price to be paid by prospective purchasers for the securities, the prospectus must show any dilution that will occur in the prospective purchasers' equity interest.

- *Capitalization.* The long-term debt and equity capital structure of the high technology company, both before and after the offering, is typically disclosed in tabular form.

Perspective: The CEO

I know that the process of going public has phases—some with critical steps and a special language, all with considerable time commitments. What are the steps? Who takes the lead? What is an "all-hands" meeting, due diligence, a "red herring," an S–I, an S–18? What effects do they have on the registration process?

Planning: The "All-Hands" Meeting



Once the CEO has selected the underwriter and other professional advisers, the company should arrange a planning meeting. The purpose of this meeting is to devise an overall detailed plan to register and sell securities. The registration team, composed of the underwriter and its counsel, the company's SEC counsel, the independent accountants, and the corporate personnel who will assist in the registration process, will all play an important role in the planning meeting.

At the planning meeting, known as an "all-hands" meeting, the registration team will develop a timetable. This timetable will cover the entire registration process, from the first "all-hands" meeting to the closing date of the offering. The managing underwriter will take the lead in developing the timetable; the SEC counsel will take the lead in drafting the registration statement; the accountant will take the lead in performing the audit and assisting with the financial statements; and the CEO and the company's management team will devote a substantial amount of time to drafting the registration statement. The underwriter, the underwriter's counsel, and the professional advisers will critically review the registration statement during its preparation.

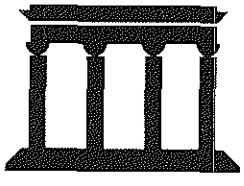
Each member of the registration team has specific responsibilities

Working together, the registration team will give careful consideration to each critical step in the registration process, including:

- Deciding on the appropriate method of filing: Form S–1 or Form S–18
- Drafting the registration statement
- Filing with the SEC
- Filing under "blue sky" laws and with NASD
- Waiting and preliminary marketing
- Going effective
- Closing

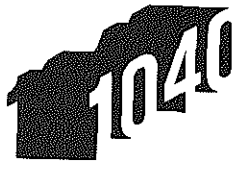
Depending upon the circumstances facing the company, the entire registration process can take from two to four months. A detailed example of a typical timetable is included at the end of this chapter.

Deciding on the Appropriate Method of Application to the SEC



The '33 Act dictates what form of registration a company uses for its initial public offering. Prior to 1984, most initial public offerings were filed on the SEC's registration application form, Form S–1. Form S–1 and its requirements are comprehensive—so comprehensive that some younger high technology companies have found the requirements difficult and sometimes impossible to meet.

In 1984, in an effort to modify those stringent requirements, the SEC adopted a new registration application form, Form S–18. Form S–18 is a simplified application designed for the company that seeks no more than $7.5 million in public capital from its initial public offering.



- Time of offering and amount of gain from the sale of shares if a secondary offering is planned by major shareholders
- Change in cash compensation—employee benefits, insurance, stock options—to be received from the company as a result of the offering

A compensation program should be:
— competitive externally
— equitable internally
— linked to the business plan

Although specific circumstances may dictate specific executive compensation packages, the overall objective of a sound compensation program is to ensure that compensation is competitive externally, equitable internally, and defined by a compensation strategy that is linked to the business plan.

The CEO should also consider when the compensation program will be installed. First, the shareholders of an emerging privately held high technology company generally offer less resistance to approving the company's compensation program than do shareholders of a public company. Second, capital appreciation plans implemented during the early stages of the company's life cycle, rather than at the public stage, offer tax advantages because the perceived value of an emerging company is less than that of a public company.

Recent prospectuses and annual proxies of comparably sized public companies in the high technology industry contain examples of effective compensation programs in the industry. Additionally, the company's professional advisers, particularly the law firm and the accounting firm, can provide guidance.

Directors' Insurance

A board of directors exercising its authority to guide the company may become subject to suits. Suits citing individuals for engaging in business other than that specified in the corporate articles, for failing to make full disclosure in connection with a public stock offering, or for taking advantage of their position as insiders have resulted in liability.



The CEO should consider the opportunity to provide two types of coverage: personal liability insurance for directors and indemnification coverage. The CEO should discuss this subject with his or her insurance providers, attorneys, and accountants to determine what coverage can be obtained, the cost, and whether the premiums are tax deductible. Additionally, the CEO should seek advice in determining whether the coverage corresponds to current standards and practices.

The issue of directors' liability and directors' insurance coverage is changing because of the frequency of suits against directors and officers by shareholders, competitors, and public interest groups. The CEO, with the help of his or her advisers, will want to monitor these changes.

In Summary . . .

Perspective: The CEO

The Assessment of the Management Team and the Board of Directors:
- The management team
- The board of directors

The Business Plan

The Compensation Strategy

Comprehensive Personal Tax Strategy

Directors' Insurance

Perspective: The CEO

If I decide to go public—can I sell the investors on my management team and my board of directors? Can I sell them on my ability to lead the company and administer the business? If I need to bring in outside experts to strengthen my management team, am I willing to share the leadership of the company with outsiders? Will my management team accept the outsiders? Then, there's the question of the business plan—do I need a strong management team to develop a sound business plan, or do I need a sound business plan to attract a strong management team? Have I realistically assessed my own strengths and weaknesses—my management team's strengths and weaknesses?

The Assessment of the Management Team and the Board of Directors

The most difficult question for the CEO who wants the public to invest in an emerging high technology company is "Does the management team have the experience to help the company grow?"

Investment bankers, venture capitalists, professional advisers, and other CEOs all agree: It's people, people, people. As one entrepreneur said,

"Investors put their money into people, and your ability to meet the competition and to overcome problems depends on the quality of your people. Take a hard, introspective look at the people in the company. You may need to make some changes."

The CEO needs to take a hard look at the management team, the board, and the business plan

The CEO will have to look at the management team, the board of directors, and the business plan from the perspective of a potential investor. Before answering this question, the CEO must assess the team's capabilities as well as his or her own capabilities. The following criteria should be considered in making the assessment:

- The growing high technology company must evolve from its state of being entrepreneurially managed to a state of being professionally managed. Growth demands delegation of duties, responsibilities, and authority.
- The management must solve new legal, accounting, administrative, and communication challenges. Going public means doing business with a whole new perspective.
- The emerging high technology company must focus its efforts on the price of its stock. The analysts and the investors will expect quarterly earnings.

The CEO must apply these criteria to the management team, the board of directors, and the business plan.

The Management Team

Underwriters and investors will be looking for a strong, capable management team. The management of the new public company will have new responsibilities and will face new challenges. In addition to managing the business of the growing high technology company, management will have to deal effectively with the requirements of the SEC and with financial analysts, the financial press, public shareholders, and professional advisers. The CEO, the board of directors, and the investors must have confidence in the management team. They must also be willing to make changes in order to build confidence.

Underwriters and investors look for a strong, capable management team

During the registration process, the SEC will require the CEO to disclose the names of each member of senior management and each member of the board of directors. The disclosures will list each member's work experience for the past five years. On the basis of the information disclosed, the investing public will judge whether the company contemplating going public has the right management—one that is capable of developing an emerging high technology company into a large, successful public company that consistently generates earnings.

The Cost of Going Public

The greatest single cost of going public is the underwriter's discount, or commission. This discount ranges from 7 percent to 10 percent of the gross proceeds from the offering, depending on the following factors:

- The size of the offering
- The type of commitment
- The type of securities

The underwriter generally does not consider the discount percentage to be negotiable outside of a narrow range. In the interest of fairness, the discount is reviewed by the National Association of Securities Dealers, Inc. (NASD).



In addition to the underwriter's discount, the company will incur legal fees, accounting fees, and printing and other costs, all of which can vary depending upon the size and circumstances of the offering.

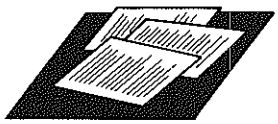
Legal fees depend upon the orderliness of the legal records and the amount of time the company's counsel spends in drafting the registration statement and participating in the process of going public.

Accounting fees depend upon the size and complexity of the emerging high technology company, the condition of the records and internal controls, the number of periods to be audited, and the company's resources in preparing the financial statements, footnotes, and registration statement.

Printing costs may range from $50,000 to $175,000, depending upon the number of proofs required between the initial proof and the final registration document, as well as the number of "red herrings" and prospectuses needed to market the stock.

Other costs—the filing fee, the "blue sky" fees, transfer agent fees, and miscellaneous fees—can range from $35,000 to $100,000.

The fees for the underwriter's counsel are paid by the underwriter.



- *Meeting regulatory requirements of the securities acts of 1933 and 1934.* Most companies that file a '33 Act registration statement are also required to be registered under the Securities Exchange Act of 1934 ('34 Act). The '34 Act requires that within 45 days of the close of each of the first three quarters, a Form 10Q must be filed with the SEC. Within 90 days of the fiscal year-end, a Form 10K must be filed. Form 8K must also be filed for specific events during the year. These reports provide financial and operational information about a public company in a timely, systematic way.

Selecting the Accountants

Accountants are critical players in the process of going public. They help the CEO present a clear financial picture of the company to both the underwriters and the investors. The importance of establishing a working relationship with an accountant several years before the possible public offering cannot be overemphasized. In selecting the accountant, the CEO should look for these qualifications:

- A firm that understands the high technology industry
- A firm that has experience with initial public offerings
- A firm that meets with the approval of the underwriters
- A firm that is experienced with SEC reporting

Other important qualifications are the reputation of the accounting firm and of the individuals assigned to the engagement.

The Attorneys



Role of the Attorneys

The attorney's role in the initial public offering begins with advising management on the decision to undertake a public offering. Once the decision to go public is made, it is imperative that the company's legal counsel be well versed and experienced in SEC matters and initial public offerings. Within the broad role of informing management of the mechanics and legal requirements of the registration process, the attorney's responsibilities will include:

- Serving as a primary contact with the SEC and the financial printer of the registration statement and prospectus.

- Acting as liaison among management, underwriters, underwriter's counsel, and accountants during the registration process.

- Coordinating the writing of the registration statement.

- Conducting corporate "housekeeping" by reviewing and completing all minutes of the board and shareholder meetings; ensuring proper authorization, amount, and class of stock; reviewing and revising articles of incorporation and bylaws; and verifying existence and ownership of all major assets.

Related-party transactions must be fully disclosed in the registration statement

- Advising on related-party transactions and full disclosures in the registration statements. Related-party transactions—transactions between the company and insiders—must be fully disclosed in the registration statement and, to a lesser extent, in the financial statements, even though disclosure of these transactions could make the growing high technology company less attractive to underwriters and investors.

With the help of the attorney, the CEO should plan ahead for ways to "depersonalize" the company. Depersonalizing can be done by making the necessary revisions to the

The Accountants

The accountant's role in assisting the CEO in going public typically begins with advice during the company's startup and rapid growth phase. During this period, the accountant will assist in critiquing the company's business plan, exploring financing alternatives, and in weighing the advantages and disadvantages of going public. During this time, the CEO must work with his or her accountant to ensure that the company has taken the steps necessary to be able to meet the strict financial statement requirements associated with a public offering.

The CEO should seek the assistance of the accountant in the following areas:

- *Developing an appropriate accounting and internal control system.* The system should provide reasonable assurances that transactions are executed in accordance with management's intended authorization, and that transactions are recorded as necessary to allow for timely, accurate financial statements prepared in accordance with generally accepted accounting principles (GAAP). The purpose of these systems is to give the CEO and management reasonable assurance that the company's assets are properly safeguarded, and that recorded amounts of assets and their physical existence are periodically matched.



While the responsibility for maintaining an adequate accounting and internal control system ultimately lies with management, the accountant should provide guidance and evaluation.

The investing public will insist upon a well-designed accounting and internal control system

The importance of a reliable accounting and internal control system cannot be overemphasized. The financial analysts and investing public will insist that the company provide timely, accurate, and reliable financial information, and this can only be accomplished with a well-designed accounting and internal control system.

- *Ensuring that the company can meet the SEC's requirements for audited financial statements.* Depending on the size of the offering and the age of the company, the SEC will require audited financial statements for a period of two to five years prior to the offering. If the CEO plans to go public within the next few years, he or she should retain an accountant to perform audits on an annual basis. While the audits may not be a requirement for running the emerging high technology company, their preparation will facilitate choosing the most advantageous time for going public.

If audits have never been performed, the CEO can anticipate potential problems. . . .

First, auditing the financial statements for the period required in the registration statement may not be possible. For example, if the growing high technology company has significant inventories, the auditors generally must observe and test the annual physical inventory counts for each of the years under audit. Since observing and testing cannot be performed after the fact, the auditors may be unable to issue an unqualified opinion on the financial statements. The SEC will not accept an audit that is limited in scope. Thus, the company will be forced to delay its public offering until such time that it can comply with the audit requirements.

Second, the results of the audit may affect the financial statements, which, in turn, may affect preliminary discussions with the investment banking firms. After the auditors have completed their procedures and the company has recorded the necessary adjustments, the earnings or trend of earnings could be unfavorable enough to cause the underwriters to cancel or delay the public offering. Reliable financial statements during the discussions with investment banking firms are extremely important.

► *The negotiations.* Once the preliminary investigation is complete and successful, the discussions between the CEO and the investment banker should include the following topics:

Types of Underwritings. The two basic types of underwriting agreements are "firm commitment" and "best efforts." *In a firm commitment underwriting, the managing underwriter agrees to purchase all of the securities offered by both the company and the selling shareholders at an agreed-upon price.* If the managing underwriter cannot sell all of the securities to the public, it will keep the unsold securities in its own account and sell them at a later date.

The overallotment option allows the underwriter to purchase additional securities above the quantity agreed upon in the firm commitment

As part of the firm commitment agreement with the high technology company, the underwriter is usually entitled to an overallotment option. This option, commonly referred to as a "green shoe," enables the managing underwriter to purchase additional securities from the company and/or its shareholders. The number of securities over the allotment of the firm commitment is an agreed-upon percentage of the quantity agreed to in the firm commitment. The percentage can be as high as 15 percent of the total shares offered. The purpose of the overallotment option is to fill excess orders for securities resulting from the offering.

Under the best efforts agreement, the underwriters agree to make their best efforts to sell the securities but do not agree to purchase the unsold securities for their own account. Best efforts agreements have variations. One variation of a best efforts agreement is the "all-or-none" agreement. If all of the securities in the offering cannot be sold, the offering is canceled. Other variations of the all-or-none agreement establish a minimum number of securities that must be sold in order to complete the offering.

Firm commitments are most desirable for the company going public

Firm commitment underwritings are the most advantageous from the growing high technology company's perspective. They assure the company that the desired funds will be raised. Best efforts agreements are less desirable; the number of securities that will be sold is a matter of uncertainty. The CEO may find that large investment banking firms are more likely to handle firm commitment agreements. The CEO should be aware, however, that since the underwriting agreement for a firm commitment underwriting is not signed until immediately prior to the offering becoming effective, the company cannot be sure the desired funds will be raised until that time.

Offering Price. At the conclusion of the preliminary investigation of the company, the investment banker formulates a proposed range of prices at which the company's securities can be sold to the public. The investment banker bases the range of prices on present market conditions and the results of the preliminary investigation. Further investigations by the investment banker during the registration process and changes in market conditions can affect the range of prices up until the day the securities are sold to the public. On the day before the registration statement is declared effective by the SEC, the managing underwriter and the company agree on the exact offering price. On the effective date, the underwriter can begin to confirm orders for the company's stock.

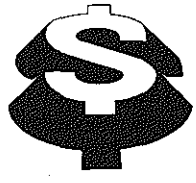
In most initial public offerings, the company offers common stock. However, initial offerings have been made of preferred stock and debentures or common stock with warrants. Until a public market exists for the common stock, a convertible security is not a practical alternative. Basic economics is the driving force behind the preference

- *Aftermarket performance.* Managing underwriters provide an important service in the aftermarket support for the shares. Aftermarket support refers to the managing underwriter's effort to "make a market" after the offering. It includes the underwriter's effort to sustain the interest of the financial community in the new public company.

The underwriter is responsible for sustaining interest in the company after the offering

The managing underwriter provides support, first, by buying and selling the company's shares from its own account after the initial offering, and, second, by employing research analysts to disseminate timely reports on the status of the new company and its products. If the managing underwriter's firm is experienced in the high technology industry, its research analysts will most likely be recognized as knowledgeable in the industry and capable of sustaining the interest of the investing public in the new company. As long as the market for the high technology company's shares exists, the new shareholders will enjoy liquidity, investor interest, and, market conditions permitting, a stable or rising stock price. Aftermarket support is an important service because it helps sustain the company's interest among the financial community.

- *Ongoing financial advice.* Ideally, the CEO should seek a relationship with an investment banker who will serve the emerging high technology company during the initial public offering and in the future. Such a relationship can help meet the long-term need for advice about future offerings—their types and amounts and timing—as well as the short-term needs of the growing company. It can also forestall the disruption associated with reeducating new investment bankers or financial advisers about the company and the industry.



- *Cost of underwriting.* The largest cost of the initial public offering is the underwriter's discount, or the commission. During the selection process, the CEO should discuss cost with each investment banking firm. However, among reputable firms the discount will not differ greatly, nor will the firms consider the discount percentage to be negotiable outside a narrow range.

Selecting the underwriter will require doing homework. The CEO can begin by identifying investment banking firms that have already underwritten initial public offerings for similar high technology companies. Sources of information may include recent prospectuses, business periodicals specializing in initial public offerings, and recommendations from the bankers, attorneys, accountants, venture capitalists, or business advisers assisting with the initial public offering. This process will identify both the established firms and the younger firms, as well as those firms with experienced principals.

The CEO is often introduced to investment bankers through a respected third-party adviser

Depending upon the results of the homework, the list can be reduced to perhaps four investment banking firms. At this point, the CEO can obtain introductions through a respected third party, such as a major accounting firm, a law firm with securities law expertise, a large commercial banker, or a venture capitalist. The introduction is an important step—it helps the CEO to gain the attention of the investment banker, who receives hundreds of unsolicited calls or letters.

Underwriters caution the CEO about "shopping around," which is loosely defined as talking to too many investment banking firms and then giving the business to the firm making the highest bid for the securities. Shopping around, it is said, will discourage the investment banker from performing a thorough investigation, which, in turn, could result in such last-minute surprises as a delay, a cancellation of an offering, or a stock price outside the range of early estimates.

Perspective: The CEO

I am weighing the pros and cons of taking my growing high technology company public. I am now asking my investment banker, attorney, accountant, and other advisers to help me understand the whole process—the sequence of events, the roles of the advisers and the CEO, the costs, and the consequences. If I go public, what is involved? Who can help me? What does it cost?

The Sequence of Events

The process of going public involves selecting an underwriter, an accountant, and an attorney; drafting the registration statement—both the prospectus and the supplemental section; printing the registration statement; filing the registration statement with the SEC for review; waiting for the SEC to respond; receiving the SEC declaration that the registration statement is effective; and, finally, closing. The entire process usually takes several months to complete.

Step One: Selecting the underwriter

Once the CEO has taken the first step—selecting the underwriter—the CEO and the management team must demonstrate to the underwriters that the emerging high technology company is ready to go public. During this time, the underwriter will do some preliminary negotiating with the CEO on the sales price of shares and the number of shares to be offered.

Step Two: Drafting the registration

Then, the CEO and the team of advisers take the second step—drafting the registration statement. Part one, the prospectus, is the offering document, which will be distributed to potential purchasers of the securities. Part two, the supplemental information, is filed with the SEC for public inspection. Drafting the registration statement is the time-consuming aspect of the process of going public.

Step Three: Printing and filing the registration statement

Step Four: Preliminary marketing of the offering

Upon completion in preliminary form, the registration statement is printed and filed with the SEC for review and comments. While the SEC regulations prevent the underwriters from taking orders and delivering securities until the registration statement becomes effective, the underwriter will form a sales and distribution syndicate during this period. The syndicate will distribute copies of the preliminary prospectus to clients and will conduct some preliminary marketing of the issue. The orders are not binding during this time; they are simply indicators of interest by investors. No shares are actually sold and delivered until the registration statement becomes effective.

Step Five: Going on the road

Additionally, the underwriter will arrange for a series of meetings to be held in various cities to promote the offering. This tour, often referred to as "the road show," gives the CEO and the management team the opportunity to tell their story to potential investors.

Step Six: Responding to SEC comments

Once the registration statement is filed, the SEC will spend four to six weeks reviewing the document (this can be longer during peak market periods), commenting, and requesting clarification about disclosures. In turn, the management team, with the assistance of counsel, offers written or verbal responses to the comments. Once the SEC is satisfied but before the registration statement is declared effective, the drafting team prepares a pricing amendment.

Step Seven: Filing the pricing amendment

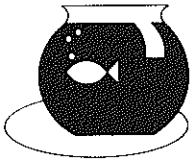
The pricing amendment is the product of negotiations between the CEO and the underwriters on price per share and number of shares to be offered. When the negotiations are complete, the revised registration statement and the pricing amendment are filed with the SEC, and the SEC declares the registration effective.

Step Eight: Closing

The final step in the process is the closing. The closing is held about one week after the effective date, giving the underwriter time to receive payments from customers. The underwriter gives the company a check for the proceeds from the offering, and the company gives the underwriter the stock certificates.

The Disadvantages

- *Stock price emphasis.* To realize the benefits of going public, management must maintain—and then increase—the market value of the company's stock. Normally, achieving consistently increasing quarterly profits will accomplish these results. The pressure to maintain an upward earning trend might cause a tendency to delay or even cancel important research and development and other expenditures with longer-term payout, sacrificing the future for the short term.



- *Life in a fishbowl.* Outsiders will have a right to know a great deal about the public company. The SEC requires that public companies disclose executive salaries, related-party transactions, competitive positions, affiliates, significant customers and suppliers, and other information. The information is required in the initial registration statement and is updated at least annually. Additionally, as part of the disclosures in the registration statement, the name of and number of shares owned by each officer, director, and shareholder who owns more than 10 percent of any class of equity security of the company must be disclosed. Management of a public company must consider both the practical and legal complexities of being a public company before making significant business decisions. Upon making a major decision, management would most likely seek a vote by the board of directors, make disclosure with the SEC, and issue a press release.

- *Expenses.* With the initial public offering, the company incurs the costs of the underwriter's commissions, filing, and out-of-pocket expenses. Depending upon the size of the offering, the underwriter's commissions may range from 7 percent to 10 percent of the total offering amount. (Chapter Three contains more information on expenses.) Additionally, the company will incur expenses for audits, annual and quarterly SEC filings, the annual report, and other costs related to its public status.

Founders may experience loss of voting control

- *Loss of voting control.* Depending upon the size of the initial public offering and subsequent offerings, the founders may experience the loss of voting control of the company.

The act of going public is significant in the life of the company and in the life of the CEO. The founders and management of the high technology company must carefully weigh each advantage and each disadvantage in light of the strategic plans and goals for taking the company public. The CEO whose strategic plan includes early selection of experienced investment bankers, attorneys, accountants, and other professional advisers will find their assistance invaluable in making the ultimate decision to go public.

For the CEO, the act of going public requires being prepared. *It requires a strategy.* As one investment banker said:

"Before going public, owners/management should be prepared for procedures, analysts, shareholders, friends, enemies, and relatives. Be prepared psychologically; don't go public if you're not ready to answer to outside forces."

Perspective: The CEO

I believe my emerging company represents an attractive investment opportunity to the public. My company is growing—it's healthy. I can demonstrate the extraordinary potential of the management team, the product, and the market. I anticipate the need to increase inventory levels and research and development, as well as expand facilities. Revenues are up, but not enough to meet the capital requirements of expansion into the European market. I need additional capital to fuel this continuing growth. The company offers both high risk and high return for potential investors—an intriguing opportunity. Should I go public to obtain the necessary capital for rapid growth? If my company is ready to go public, what's my strategy before I begin?

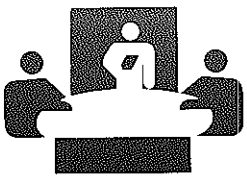
The Opportunities

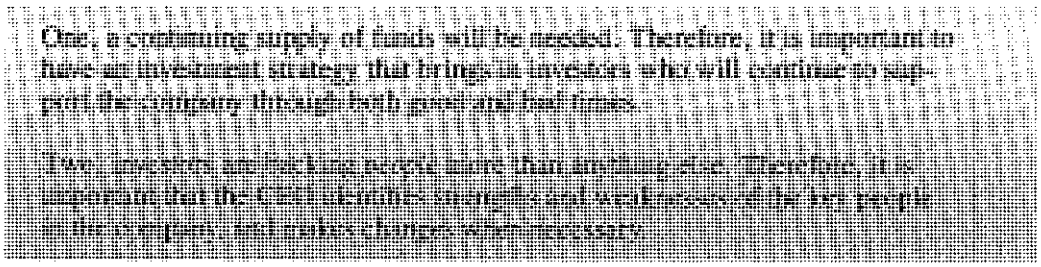
For the successful CEO, the thought of an initial public offering (IPO) is intriguing. The IPO represents a significant achievement—taking an innovative product to the domestic or international market and gaining public acceptance. And, the IPO represents financial opportunities for the CEO: liquidity for early-stage investors, opportunities for increased working capital, stock-based incentive compensation opportunities for executives and key employees, an improved financial picture, and the prestige of public stature.

The Strategy

Successful IPOs may catapult the high technology company into a new arena, which demands a highly experienced management team, a strong board of directors, a dynamic business plan, a clear corporate image, an active network of underwriters and investors, and strong relationships with professional advisers, all of which require a plan, a strategy for going public.

As one CEO stated, successful CEOs learn two important lessons about financing the high technology company from startup through going public:





With these lessons in mind, he adds, *"There has never been a better time to get started."*

The Role of the CEO



Whether the CEO is considering taking the company public within the next year or in the next three years, it is never too early to develop a strategy for going public. That strategy should be based on the CEO's careful assessment of the management team, the board of directors, the underwriters, the accountants, and the attorneys. Working in concert, this team of internal and external advisers will assist the CEO in developing a strategy for going public.

Once the CEO makes the decision to go public, he or she will be actively involved as the registration statement drafting team assembles for the first of many long, arduous meetings to plan, discuss, draft, and revise the registration statement. He or she will be expected to represent the company in intensive face-to-face meetings with potential investors and analysts, who will want to know about the company, the product, and the prospectus—*all of which require a substantial commitment of time.*

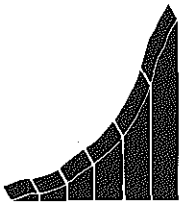
The SEC's purpose in requiring the filing of the registration statement is not to judge the merits of an offering. Rather, the SEC acts to ensure that details about the company are fully disclosed in the registration statement so that the investing public can make informed decisions about whether to invest in the company's securities.

Characteristics That Typify a Successful Public Company

Because the investing public wants to make a sound investment, underwriters and investors will look for characteristics that typify the successful public company in the high technology industry. Specifically, the investment community will look for:

- *Sound management.* The experience, integrity, and commitment of the management team are critical to the success of obtaining public financing.
- *Technological innovation.* Innovative products and exclusive services or applications are very important.
- *High performance.* A track record demonstrating annual revenues of $20 million, net earnings of $1 million in the past year, and the potential of achieving $100 million in annual revenues in the next five to ten years typically represents significant factors in obtaining public financing. However, because of the exceptional promise of some high technology companies, underwriters and investors may encourage a public offering even before the company has established a significant track record.
- *Domestic and international growth.* The company's size, marketing strategy, and expansion opportunities in the United States and in foreign countries increase the potential for success in obtaining public financing.

The CEO must demonstrate the company's potential for success



Revenues

If the CEO believes that the emerging high technology company is an attractive investment opportunity for the public, and if the CEO can demonstrate the extraordinary potential of the company's management team, the product, and the market, then the CEO might want to undertake a detailed if–then analysis. It is never too early to begin this process, since the path to going public requires a plan and a strategy toward this goal.

In Summary . . .

Perspective: The CEO

The Path to the Public Market:
- Research and development
- Startup
- Early growth
- Accelerated growth
- Initial public offering

A Bypass to the Exchanges

The Challenge:
- Registration
- Disclosure

Characteristics That Typify a Successful Public Company:
- Sound management
- Technological innovation
- High performance
- Domestic and international growth

chapter five

If I Go Public—What Are the Critical Steps?	29
Planning: The "All-Hands" Meeting	30
Deciding on the Appropriate Method of Application to the SEC	30
Drafting the Registration Statement	31
Filing with the SEC	35
SEC Review	35
Amendments	36
Pricing	36
Filing Under "Blue Sky" Laws and with NASD	37
Waiting and Preliminary Marketing	37
The Road Show	37
Due Diligence	38
Going Effective	38
Closing	38
Developing the Timetable	39

chapter six

If I Go Public—How Public Is Public?	43
The Value of the Stock	44
The Use of Proceeds	44
Periodic Reporting	44
Proxy Solicitations	45
Tender Offers and Reports by 5 Percent Shareholders	45
Insider Reporting and "Short Swing" Profits	46
Rule 144: Resale of Restricted Securities	46
Listing Securities on a Stock Exchange	47

chapter seven

The Foreign Exchanges—What Are the Opportunities for Going Public Outside the United States?	49
The Foreign Exchanges	50
Interviews with KPMG's High Technology Professionals in:	50
London	51
Vancouver	54
Toronto	56
Paris	59
Frankfurt	62
Amsterdam	63
Hong Kong	64
Singapore	65

appendixes

Summary of Financing Approaches for High Technology Companies	70
Glossary	76